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In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND COMPANY, REORGANIZED KANSAS METALS COMPANY, REORGANIZED ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED DENVER METALS COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORPORATION, AND REORGANIZED COLORADO AND WYOMING RAILWAY COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the claim of the United States against the debtor in bankruptcy for an excise tax owed under Section 4971(a) of the Internal Revenue Code, 26 U.S.C. 4971(a), is entitled to the distributive priority for an "excise tax" provided by Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E) (1988).[1]

2. Whether, in the absence of inequitable conduct by the government in obtaining or enforcing its claim, the excise tax claim of the United States under Section 4971(a) of the Internal Revenue Code may be subordinated to general unsecured claims under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, 11 U.S.C. 510(c).[2]

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[1] Section 304(c) of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4132, added a new seventh priority for alimony and child support claims and changed the preexisting priority for excise taxes from seventh to eighth. Those amendments have no significance for the issues presented in this case.

[2] A closely analogous question concerning the proper scope of the "principles of equitable subordination" in bankruptcy cases is presented in *United States* v. *Noland,* 48 F.3d 210 (6th Cir. 1995). We are concurrently filing a petition for a writ of certiorari in that case. Because of the closeness of the issues presented in these two cases, we suggest that both petitions be granted and that the cases be set for argument in tandem.

We have furnished a copy of the petition in *United States* v. *Noland* to counsel for the respondents in this case. We have also furnished a copy of the petition in this case to the respondent in *United States* v. *Noland.*

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-9a) is reported at 53 F.3d 1155. The opinion of the district court (App., *infra*, 10a-11a) is unre-

ported. The opinion of the bankruptcy court (App., *infra*, 38a-62a) is reported at 148 B.R. 332.

JURISDICTION

The judgment of the court of appeals was filed on April 27, 1995. On July 14, 1995, Justice Breyer extended the time for filing a petition for a writ of certiorari to and including August 25, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant portions of Sections 507(a)(7) and 510(c) of the Bankruptcy Code, 11 U.S.C. 507(a)(7) and 510(c) (1988), and of Section 4971 of the Internal Revenue Code, 26 U.S.C. 4971, are set forth in the Appendix, *infra*, at 63a-66a.

STATEMENT

1. Respondents are the CF&I Steel Corporation and its nine wholly owned subsidiaries. Prior to 1990, these corporations maintained defined-benefit pension plans for their employees that were subject to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.* For the year that ended on December 31, 1989, respondents failed to make required pension plan contributions of $12,400,000. The plans therefore had an "accumulated funding deficiency" equal to that amount. See 26 U.S.C. 412(a). In November 1990, respondents filed petitions for reorganization under Chapter 11 of the Bankruptcy Code (App., *infra*, 2a).

Subtitle D of the Internal Revenue Code is entitled "Miscellaneous Excise Taxes." One of the provisions

of that subtitle—Section 4971(a) of the Internal Revenue Code—imposes a 10 percent excise tax on the amount of any "accumulated funding deficiency" of qualified pension plans. 26 U.S.C. 4971(a). The excise tax liability for respondents' "accumulated funding deficiency" under Section 4971(a) was therefore approximately $1,240,000. The Internal Revenue Service filed proofs of claims for that amount in respondents' bankruptcy case (App., *infra*, 2a-3a).[3]

The government's proofs of claim assert that the liability for this excise tax under Section 4971(a) of the Internal Revenue Code is entitled to seventh priority in the distribution of the assets of the debtors' estates under Section 507(a)(7)(E) of the Bankruptcy Code.[4] As applicable to this case, Section

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[3] The proofs of claim filed by the United States also asserted (i) priority claims for excise taxes under Section 4971(a) for the subsequent plan year, (ii) priority claims for excise taxes under Section 4971(b) for both the 1989 and 1990 plan years, (iii) nonpriority claims for penalties related to the Section 4971(a) excise tax for 1989 and (iv) priority claims for income taxes for various years. Section 4971(b) of the Internal Revenue Code imposes an additional excise tax, equal to 100 percent of the "accumulated funding deficiency," on employers who fail to correct the deficiency within a specified period. 26 U.S.C. 4971(b). The government did not appeal the adverse rulings relating to those claims.

[4] The Pension Benefit Guaranty Corporation (PBGC) also filed proofs of claim in this case. The PBGC guarantees payment of certain vested benefits under terminated pension plans. See 29 U.S.C. 1301 *et seq.* The PBGC obtains funds for that purpose from insurance premiums paid by the employers whose pension plans are subject to Title IV of ERISA. See 29 U.S.C. 1306. In March 1992, when one of the debtors' pension plans was terminated, the PBGC became the statu-

507(a)(7)(E) provides a "[s]eventh" priority for governmental claims for any "excise tax" that arose during the three years immediately preceding the date of the filing of the bankruptcy petition. See 11 U.S.C. 507(a)(7)(E)(i) and (ii) (1988); note 1, *supra*. Section 507(a)(7)(G) of the Bankruptcy Code provides the same "[s]eventh" priority to a statutory penalty that is "related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss." 11 U.S.C. 507(a)(7)(G) (1988).

Respondents filed an objection to the government's claim. They argued that the excise tax claims under Section 4971(a) were neither a "tax" nor a penalty compensating for pecuniary loss and should therefore be denied any priority under Section 507 of the Bankruptcy Code.

2. The bankruptcy court allowed the government's claim under Section 4971(a) of the Internal Revenue Code but denied that claim any priority under Section 507(a)(7)(E) of the Bankruptcy Code. The court recognized (App., *infra*, 47a-48a) that, in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991), cert. denied, 502 U.S. 1092 (1992), the Sixth Circuit held that the excise tax imposed by Section 4971(a) must be given priority in bankruptcy. In *Mansfield Tire*, the court reasoned that, since Congress denominated Section 4971 as an excise tax and further expressly provided that claims for excise taxes have priority in bankruptcy under Section 507(a)(7)(E), the plain language of the statutes must be followed without regard to the underlying "purpose" served by the tax. 942 F.2d at 1059. The bankruptcy court, however, rejected the Sixth Circuit's ruling as "unnecessarily rigid" (App., *infra*, 48a). The court stated that the fact that Congress denominated the tax imposed by Section 4971 as an excise tax should be disregarded in applying the Section 507(a)(7)(E) priority provision, for "blind acceptance of the label would defeat the purpose of the Bankruptcy Code" (App., *infra*, 49a).

The court concluded that allowing a priority for the excise tax imposed under Section 4971(a) would be anomalous for several reasons. First, the court expressed concern that priority treatment of the excise tax claim would elevate that claim above the PBGC's claims for the underlying funding deficiency (App., *infra*, 51a; see note 4, *supra*). Second, the court stated that, because bankruptcy courts may independently review state and local exactions to determine whether they represent a priority "tax" or a non-priority penalty, a failure similarly to review federal exactions would result in a "disparate treatment" that "the Bankruptcy Code does not contemplate" (App., *infra*, 51a). Third, the court stated that payment of priority excise tax claims would burden respondents' efforts to reorganize, would diminish the return to other creditors and would give

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tory trustee for the plan pursuant to 29 U.S.C. 1342. The PBGC thereby became liable to plan participants for guaranteed benefits.

The PBGC filed proofs of claim in the bankruptcy case seeking to recover unpaid pension plan contributions. The PBGC also sought to recover its own statutory claims for unfunded benefits. The bankruptcy court concluded that most of the PBGC's claims were unsecured and had no priority in distribution of the assets of the estates. The district court upheld those rulings. *PBGC* v. *Reorganized CF&I Fabricators of Utah, Inc.*, 179 B.R. 704 (D. Utah 1994).

a "windfall" to the government (*ibid.*). Fourth, because the priority excise tax claims would be paid before the claims of the pensioners themselves, the court stated that the excise tax priority would harm the very parties that Section 4971 was intended to protect (*ibid.*). For these reasons, the court concluded that it must be "empowered, under the circumstances of this case, to look behind the characterization of the exaction set forth in the statute and focus on the actual nature of the claims" (*id.* at 52a).

The bankruptcy court applied what it termed the *Lorber Industries* "test" to determine the "actual nature" of the tax (App., *infra*, 52a). That test derives from *County Sanitation District No. 2* v. *Lorber Industries of California, Inc.*, 675 F.2d 1062 (9th Cir. 1982), which was a bankruptcy case involving collection of a county sewer use fee. The Ninth Circuit held in that case that the following four elements characterize a "tax," as distinguished from a user fee, for purposes of determining entitlement to priority under the former Bankruptcy Act:

> (a) An involuntary pecuniary burden, regardless of name, laid upon individuals or property;
>
> (b) Imposed by or under authority of the legislature;
>
> (c) For public purposes, including the purposes of defraying expenses of government or undertakings authorized by it;
>
> (d) Under the police or taxing power of the state.

675 F.2d at 1066. In the present case, the bankruptcy court concluded, under "its own independent application" of the *Lorber* standard, that the excise tax

imposed under Section 4971(a) is not a "tax" but is in the nature of a penalty and is therefore not entitled to priority under Section 507(a)(7) of the Bankruptcy Code (App., *infra*, 52a).

3. The United States appealed to the district court. While that appeal was pending, respondents issued a proposed plan of reorganization. The United States objected to the proposed plan because it failed to make provision for payment of the Section 4971(a) excise tax in the event that the United States prevailed on its appeal of the priority issue. The bankruptcy court nonetheless confirmed the plan. The United States appealed from the order of confirmation.

In the meantime, respondents initiated an adversary proceeding in their bankruptcy case, seeking to subordinate the Section 4971(a) excise tax claims to the claims of general unsecured creditors. Respondents relied on Section 510(c) of the Bankruptcy Code, which authorizes bankruptcy courts to apply "principles of equitable subordination [to] subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." 11 U.S.C. 510(c). Respondents contended that the "principles of equitable subordination" permit the court to subordinate claims for "penalties" even if the holder of the claim has not engaged in any inequitable conduct. The bankruptcy court agreed with respondents and ordered the Section 4971(a) excise tax claim to be "subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c)" (App., *infra*, 21a). The United States appealed that order.

4. a. Twelve days after the bankruptcy court issued its original order denying priority to the Section

4971(a) tax, the Tenth Circuit issued its decision in *United States* v. *Dumler*, 983 F.2d 161 (1992). That case involved the bankruptcy priority of the government's claim for the 10 percent "additional tax" imposed under Section 72(t) of the Internal Revenue Code upon early distributions from qualified retirement plans. The question in *Dumler* was whether that "additional tax" (26 U.S.C. 72(t)) is a "tax on or measured by income" that is entitled to seventh priority in bankruptcy under 11 U.S.C. 507(a)(7)(A). The Tenth Circuit held in *Dumler* that, although Section 72(t) purports to impose a "tax," it in fact imposes a "penalty" for a nonpecuniary loss and therefore has no priority in bankruptcy.[5] 983 F.2d at 164-165. In reaching that conclusion, the Tenth Circuit stated that it rejected the reasoning of the Sixth Circuit in *Mansfield Tire* and held that it could "recharacterize for purposes of bankruptcy what Congress has deemed a tax in the Internal Revenue Code." 983 F.2d at 162, citing *In re Unified Control Systems, Inc.*, 586 F.2d 1036 (5th Cir. 1978).

b. In the present case, the district court consolidated the government's appeals from the orders of the bankruptcy court that (i) denied priority to the Section 4971(a) claim, (ii) confirmed the plan of reorganization and (iii) subordinated the Section 4971(a) claim to the claims of all general unsecured creditors. The district court affirmed all three orders, reasoning that the Section 4971(a) excise tax "is

[5] The question whether the doctrine of equitable subordination would permit subordination of such a claim to all other general unsecured claims was not presented in *United States* v. *Dumler*.

a nonpecuniary loss penalty, not a tax" (App., *infra*, 18a). The court stated that equitable subordination of the government's claim is appropriate "primarily" for the reasons set forth in the Tenth Circuit's opinion in the *Dumler* case (App., *infra*, 18a). But see note 5, *supra*.

5. The court of appeals affirmed (App., *infra*, 1a-9a). Relying on its previous decision in *Dumler*, the court held that the name that Congress gives an exaction under the Internal Revenue Code does not determine its status in applying the priority provisions of Section 507(a)(7) of the Bankruptcy Code. The court stated that whether an exaction is a "tax" or a "penalty" for purposes of bankruptcy priority is to be determined by application of the four-part test of *Lorber Industries* (App., *infra*, 6a). Under this test, the court concluded that the Section 4971(a) excise tax is in substance a "penalty," rather than a "tax," "for substantially the reasons given by the bankruptcy court" (App., *infra*, 6a).

The court then addressed the equitable subordination of the government's claim. The court first noted that, "[b]ecause we have determined that the [claim of the United States in this case] is a nonpecuniary loss penalty not entitled to section 507 priority," the court had no reason to consider whether a claim that *is* entitled to priority under Section 507 may be subordinated to other claims under the "principles of equitable subordination" (App., *infra*, 6a).[6] The

[6] Whether a "case-by-case" balancing of the "equities" may be applied to subordinate a claim that the court believes to be "unfair" to other creditors even when Congress has expressly designated such a claim as a priority claim in Section 507 of the Bankruptcy Code—a question that the court of appeals

court then acknowledged that equitable subordination historically has been imposed only when a creditor has engaged in wrongful conduct and that "the bankruptcy court expressly found that 'there [had] been no inequitable conduct on the part of the Internal Revenue Service'" in this case (App., *infra*, 6a, 7a). The court stated, however, that in codifying the "principles of equitable subordination" in Section 510(c) of the Bankruptcy Code, "Congress intended courts to continue developing" those principles (App., *infra*, 7a). The court reasoned that the "developing" principles of equitable subordination permit a court (*id.* at 8a, quoting *In re Virtual Network Services Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990)):

> to equitably subordinate claims to other claims on a case-by-case basis without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors.

In particular, the court held that these developing "principles of equitable subordination" do "not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims" (App., *infra*, 8a, citing *e.g.*, *Burden* v. *United States*, 917 F.2d 115, 116-120 (3d Cir. 1990); *Schultz Broadway Inn* v. *United States*, 912 F.2d 230, 231-234 (8th Cir. 1990)).

Turning to "the equities in this case" (App., *infra*, 8a), the court held that subordination is appropriate because the PBGC and other "general unsecured creditors of CF&I will receive only a small percent-

asserted that it was not required to reach in this case—was addressed and answered affirmatively in *United States* v. *Noland*, *supra*. See note 2, *supra*.

age of their claims" and [d]eclining to subordinate the [excise tax claim of the United States] would harm innocent creditors rather than punish the debtor for failing to fund the pension plan" (*ibid.*).

REASONS FOR GRANTING THE PETITION

This case presents two closely related questions of substantial recurring importance. The first concerns whether the statutory priority for an "excise tax" is available only if the underlying purpose of the excise tax is to raise revenue rather than discourage conduct. Both the plain language and the clear history of Section 507(a)(7)(E) of the Bankruptcy Code reflect that the priority that Congress granted to "excise taxes" is not conditioned on a finding that the excise tax is primarily designed to raise revenues. As the court of appeals acknowledged (App., *infra*, 4a, 48a; see *United States* v. *Dumler*, 938 F.2d at 162), its decision on this issue directly conflicts with the contrary decision of the Sixth Circuit in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059. The proper scope of the statutory priority for "excise tax" claims under Section 507(a)(7)(E) of the Bankruptcy Code is frequently litigated and often involves substantial sums. Absent further review by this Court, the conflicting understandings of Section 507(a)(7)(E) that the courts of appeals have adopted will engender wasteful litigation and result in disparate treatment of otherwise identical claims.

The second question presented in this case concerns whether, under the judge-made "principles of equitable subordination" that Congress codified in Section 510(c) of the Bankruptcy Code, a bankruptcy court may subordinate the claim of a creditor who has

not acted in an inequitable or wrongful manner. By assuming an authority to subordinate the claim of an innocent creditor in order to prefer the claim of other creditors who have *not* been granted priority by Congress, the decision in this case conflicts with the established rule that "principles of equitable subordination" do *not* permit a court to make "abstract legislative judgments about the fairness of a result contemplated by the legislature's statutory scheme if it has otherwise been followed in good faith and without overreaching." *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d 784, 787 (9th Cir.), cert. denied, 423 U.S. 913 (1975). In applying the doctrine of "equitable subordination" to subordinate the claim of an innocent creditor, the decision in this case broadens an existing conflict among the courts of appeals. The authority that the court assumed to engage in a "case-by-case" analysis of what is "fair" in the distribution of a debtor's assets loosens the doctrine of "equitable subordination" from its established moorings; it also threatens to disrupt the ordinary enforcement not only of excise taxes but of other types of tax and private claims as well.

1. a. The court of appeals erred in holding that the excise tax imposed by Section 4971(a) of the Internal Revenue Code is not entitled to the priority that Congress expressly provided for an "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code. Congress enacted Section 4971 of the Internal Revenue Code as part of the Employee Retirement Income Security Act of 1974 (ERISA). In connection with the qualified pension plan arrangements authorized by ERISA, Section 4971 was enacted to "impose[] an excise tax on the employer if he fails to fund the plan at the minimum required amounts." H.R. Rep. No. 807, 93d Cong., 2d Sess. 97 (1974).

Even before the Bankruptcy Code was enacted in 1978, Congress thus expressly designated the tax imposed by Section 4971 as an "excise tax" (*ibid.*; see also S. Rep. No. 383, 93d Cong., 1st Sess. 24, 33, 70 (1973)). Section 4971 was placed within Subtitle D of the Internal Revenue Code—which is entitled "Miscellaneous Excise Taxes"—precisely because Congress understood and intended that Section 4971 *is* an "excise tax" (H.R. Rep. No. 807, *supra*, at 97).

When the Bankruptcy Code was enacted, one of the changes that it made to the provisions of the former Bankruptcy Act was the new, express specification of a priority for "excise tax" claims. Compare 11 U.S.C. 507(a)(7)(E) (1988) with 11 U.S.C. 104(a) (1976). The joint floor statements that accompanied enactment of the Bankruptcy Code in 1978 described the intended scope of this specific "excise tax" priority:

> All Federal, State, or local taxes *generally considered or expressly treated as excises* are covered by this category, including sales taxes, estate and gift taxes, gasoline and special fuel taxes, and wagering and truck taxes.

124 Cong. Rec. 32,416 (1978) (Rep. Edwards) (emphasis added); *id.* at 33,998, 34,016 (Sen. DeConcini) (same).

Since Congress "expressly treated" the excise tax created under Section 4971 of the Internal Revenue Code as an "excise tax" even before the Bankruptcy Code was enacted, the Sixth Circuit correctly concluded in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059, that this tax is entitled to the priority established by Section 507(a)(7)(E). As this Court stated in *United States* v. *Ron Pair Enter-*

prises, Inc., 489 U.S. 235 (1989), when the language of the Bankruptcy Code is plain, "the sole function of the courts is to enforce it according to its terms." *Id.* at 241, quoting *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917). While resort to the legislative history of these provisions is therefore unnecessary, that history leaves no room for any different conclusion.

In particular, the court of appeals erred in concluding that an "excise tax" that exacts a "penalty" is not an "excise tax" within the meaning of Section 507(a)(7)(E) of the Bankruptcy Code. As the Sixth Circuit explained in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059, Congress expressly granted priority to any "excise tax" without adding any limitation based upon the "purpose" of the tax. Moreover, Congress clearly understood that an excise tax is no less an "excise tax" because it has a regulatory or punitive purpose. Excise taxes in the Internal Revenue Code are often imposed on disfavored activities and are often designed to discourage or punish undesirable conduct. See, *e.g.*, 26 U.S.C. 4064 (gas guzzler tax), 4681 (Supp. V 1993) (tax on ozone-depleting chemicals), 4701 (tax on "registration-required" obligations issued in bearer form), 4911 (tax on excess lobbying by public charities), 4941 *et seq.* (tax on undistributed income and speculative investments of private foundations), 4955 (tax on political expenditures by Section 501(c)(3) organizations), 4981 and 4982 (taxes on undistributed income of real estate investment trusts and regulated investment companies), 4999 (tax on "golden parachute" payments), 5881 (tax on "greenmail"). If Congress had intended to exclude so many federal excise taxes from the excise tax priority, one would

expect to find some indication to that effect in the Bankruptcy Code or in its legislative history. Instead, the legislative history specifies that the priority for excise taxes comprehensively includes "[a]ll [f]ederal, [s]tate or local taxes generally considered or expressly treated as excises" (124 Cong. Rec. at 32,416 (Rep. Edwards) (listing the excise tax on "wagering" as one example).

The text of the Bankruptcy Code provides further evidence that Congress intentionally omitted any distinction among excise taxes in enacting the priority for such taxes in Section 507(a)(7)(E). In Section 507(a)(7)(G), Congress expressly drew a distinction among different types of tax-related *penalties* and established a priority only for such penalties that are "in compensation for actual pecuniary loss" (11 U.S.C. 507(a)(7)(G)). As this Court has observed, "it is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another" (*City of Chicago* v. *Environmental Defense Fund*, 114 S. Ct. 1588, 1593 (1994), quoted in *BFP* v. *Resolution Trust Corp.*, 114 S. Ct. 1757, 1761 (1994)). That presumption is especially appropriate when, as here, language conditioning an express priority is used in one paragraph and omitted in another paragraph of the same subsection of the statute. If Congress intended to exclude from the priority for "excise taxes" any excise tax that might be "punitive" rather than "compensatory," it surely knew how to do so. Instead, it deliberately chose *not* to do so.

b. The four-part *Lorber Industries* standard on which the court of appeals relied (see page 9, *supra*) has no proper application in this context.

That test was formulated by the Ninth Circuit to determine whether an exaction that a State describes as a priority "tax" is instead a non-priority user fee. See 675 F.2d at 1066. Whatever relevance that analysis may have in determining whether an exaction is a "tax" for purposes of the bankruptcy priority for a "tax on or measured by income" (11 U.S.C. 507(a)(7)(A)), it has no relevance in determining whether an exaction is an "excise tax" under Section 507(a)(7)(E).[7] As both the legislative history of

[7] *United States* v. *Dumler,* 983 F.2d at 163-164, concerned whether the challenged exaction was a "tax on or measured by income" for purposes of the priority established in Section 507(a)(7)(A) of the Bankruptcy Code. The court of appeals did not attempt in this case to explain why the analysis of that decision should be applied in determining whether an exaction is an "excise tax" under the more specific provisions of Section 507(a)(7)(E) of the Code. As we describe in the text, an "excise tax" is often, if not ordinarily, designed to accomplish regulatory or punitive objectives, as well as raising revenue.

This Court's decisions in *City of New York* v. *Feiring,* 313 U.S. 283 (1941), and *New Jersey* v. *Anderson,* 203 U.S. 483 (1906), on which the court of appeals relied in *United States* v. *Dumler,* 983 F.2d at 163, involved whether state and local exactions constituted "taxes" for purposes of priority for taxes under the former Bankruptcy Act. As the Sixth Circuit noted in *United States* v. *Mansfield Tire & Rubber Co.,* 942 F.2d at 1060, although it is appropriate carefully to review the designation of state and local exactions to insure that such claims are not improperly promoted within the federal priority scheme, courts are not free to recast an exaction that Congress has designated as a "tax" to be something else. In *A. Magnano Co.* v. *Hamilton,* 292 U.S. 40, 43 (1934), this Court stated that whether an exaction is for the public purpose of raising revenues turns on "the use which is to be made of the revenue derived from the tax, and not [on] any ulterior motive or purpose which may have influenced the legislature in passing the act." In any event, for the reasons we have explained, cases involving a general priority for "taxes" are not relevant in determining the scope of the more specific priority for "excise taxes" under Section 507(a)(7)(E).

that Section and its plain text reflect, the priority for an "excise tax" applies to all such exactions "generally considered *or* expressly treated as excises" (124 Cong. Rec. at 32,416) (Rep. Edwards) (emphasis added). The plain text of the Bankruptcy Code should not have been disregarded by the court of appeals. See, *e.g.*, *Patterson* v. *Shumate,* 504 U.S. 753, 757-759 (1992); *Connecticut National Bank* v. *Germain,* 503 U.S. 249, 253-254 (1992); *United States* v. *Ron Pair Enterprises, Inc.,* 489 U.S. at 242.

c. As the court of appeals recognized, the decision in this case directly conflicts with the decision of the Sixth Circuit in *United States* v. *Mansfield Tire & Rubber Co.,* 942 F.2d at 1059-1060. The question addressed in these conflicting decisions—whether bankruptcy courts may deny the statutory priority for taxes based upon a perceived punitive purpose of the tax—is frequently litigated and often involves substantial sums. Compare *United States* v. *Unsecured Creditors' Committee of C-T of Virginia, Inc.,* 977 F.2d 137 (4th Cir. 1992) (the 10 percent tax for withdrawals from a qualified pension plan is a priority "excise tax," not a penalty), cert. denied, 113 S. Ct. 1644 (1993), with *United States* v. *Dumler,* 983 F.2d at 162 (the 10 percent tax under Section 72(t) is a non-priority "penalty"), and *In re Unified Control Systems, Inc.,* 586 F.2d at 1037-1038 (a tax that is a "penalty" is not entitled to priority). See also *In re Juvenile Shoe Corp. of America,* 166 B.R. 404 (Bankr. 1994), rev'd, 180 B.R. 206 (E.D.

Mo. 1995), appeal pending, No. 95-2289 (8th Cir.); *Seidle* v. *United States*, 120 B.R. 597 (S.D. Fla. 1990); *United Steelworkers of America* v. *PBGC*, 103 B.R. 672 (Bankr. W.D. Pa. 1989). Absent resolution by this Court of this important recurring question, the existing conflict among the courts of appeals will produce repetitive and wasteful litigation that will result in disparate treatments of otherwise identical claims and debtors.

2. The court of appeals further erred in concluding that, under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, a bankruptcy court is to evaluate the "equities" of the claims of innocent creditors on a "case-by-case" basis to arrive at a distribution scheme that the court deems fair to all creditors (App., *infra*, 8a). In particular, the court erred in applying that rationale to subordinate the "penalty" claims of innocent creditors (*ibid.*). The expansive powers that the court has assumed under the doctrine of equitable subordination reflect a serious misapplication of that doctrine.

By enacting a specific set of statutory priorities, Congress has itself measured the "equities" of the various classes of claims. *Carpenter* v. *Wabash Ry.*, 309 U.S. 23, 28 (1940). Claims that Congress has placed within the same class are to be treated on identical terms. Equitable subordination does not authorize a court to "reweigh" the equities that Congress itself has already adjusted. As we explain in detail in the petition for a writ of certiorari in *United States* v. *Noland* (see note 2, *supra*), the doctrine of equitable subordination permits a court to subordinate a particular claim only if the claimant has acted inequitably in obtaining or enforcing its

claim, to the detriment of other creditors. See, *e.g.*, *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 787; *In re Columbia Ribbon Co.*, 117 F.2d 999, 1002 (3d Cir. 1941). The issue that is to be resolved under "principles of equitable subordination" is whether (2 Collier Bankruptcy Manual ¶ 510.01[1], at 510-2 (3d ed. 1995)):

> harmful conduct [of the claimant] was directed at other creditors. If it was, the claim which is otherwise provable and allowable should be postponed until the claims of the creditors, who were harmed, have been satisfied.

See *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 229 (1948); *Pepper* v. *Litton*, 308 U.S. 295, 311 (1939); *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, 323 (1939); *Benjamin* v. *Diamond*, 563 F.2d 692, 699 (5th Cir. 1977); Herzog & Zweibel, *The Equitable Subordination of Claims in Bankruptcy*, 15 Vand. L. Rev. 83, 85 (1961). As the Ninth Circuit held in *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 787: [8]

> [I]t is important to keep in mind that the chancellor never did, and does not now, exercise unrestricted power to contradict statutory or

[8] Similarly, in *New Jersey* v. *Anderson*, 203 U.S. 483 (1906), this Court rejected the assertion that a statutory priority for state taxes should not be recognized because it created an "injustice" for other creditors and gave the State an undue "advantage" (*id.* at 490):

> [C]onsiderations of this character, however properly addressed to the legislative branch of the government, can have no place in influencing judicial determination. It is the province of the court to enforce, not to make the laws, and if the law works inequality the redress, if any, must be had from Congress.

common law when he feels a fairer result may be obtained by application of a different rule. Courts of equity have long applied standards of conscience to conduct on an individual basis to prevent formally proper but unconscionable applications of legal rules; they have not engaged in the practice of making abstract legislative judgments about the fairness of a result contemplated by the legislature's statutory scheme if it has otherwise been followed in good faith and without overreaching.

By subordinating the statutory claims of innocent creditors for "nonpecuniary loss" penalties, the decision in this case reaches a result that is directly contrary to the statutory treatment that Congress enacted for such claims. In enacting the Bankruptcy Code, Congress considered and rejected a proposal to subordinate all "nonpecuniary loss" penalty claims under all chapters of the Code. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. II at 115, § 4-406(a)(3) (1973). Instead, Congress provided for the subordination of "nonpecuniary loss" penalties only in Chapter 7 cases. See 11 U.S.C. 726(a)(4). In Chapter 11 cases, such as the present one, Congress left such penalties within the class of general unsecured claims. Through misapplication of the "principles of equitable subordination," however, the decision in the present case rejects and annuls that specific legislative determination.

The Sixth Circuit's invocation of the "principles of equitable subordination" to subordinate a first priority claim in *United States* v. *Noland*, 48 F.3d 210 (1995), and the Tenth Circuit's invocation of the same principles to subordinate what the court regarded as a

general unsecured claim in the present case are closely related variants of the same error.[9] In both instances, the court substituted its judgment about the relative worthiness of a category of claims for the judgment that Congress made in enacting the Bankruptcy Code. In holding that a statutory "penalty" that was asserted in good faith and in compliance with law is to be subordinated to make the distribution to other creditors more "fair" than under the scheme that Congress enacted, the decision in this case simply disagrees with (and reaches a result precisely at odds with) the statutory scheme. As the Ninth Circuit stated in *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 788, the doctrine of equitable subordination does not permit a court to say, "in effect, * * * the distribution scheme provided by the [Bankruptcy] Act is a mistake."

In the petition for a writ of certiorari that we are filing concurrently in *United States* v. *Noland*, we describe the conflict that exists among the courts of appeals in their application of the "principles of equitable subordination." See note 2, *supra*. That petition also describes the substantial recurring importance of this question and the significant need for review by this Court of the recent decisions that have misapplied the doctrine of equitable subordination in bankruptcy cases. For the reasons set forth in that

[9] In *United States* v. *Noland*, 48 F.3d at 210, the Sixth Circuit applied "principles of equitable subordination" to subordinate a claim that the court acknowledged was entitled to "[f]irst" priority under Section 507(a) of the Bankruptcy Code. In the present case, the Tenth Circuit applied "principles of equitable subordination" to subordinate a claim that the court erroneously held was *not* entitled to priority under Section 507(a)(7)(E) of the Code.

petition, and for the reasons stated above, the petitions in both cases should be granted. Because the two cases present related but different aspects of the same analytical issue, we suggest that the cases be set for argument in tandem.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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AUGUST 1995

APPENDIX A

[Filed Apr. 27, 1995]

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 94-4034
94-4035
94-4036

IN RE: CF&I FABRICATORS OF UTAH, INC., DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORATO & UTAH LAND COMPANY, REORGANIZED KANSAS METALS COMPANY, REORGANIZED ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED DENVER METALS COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORPORATION, REORGANIZED THE COLORADO AND WYOMING RAILWAY COMPANY, APPELLEES

Appeal from the United States District Court for the District of Utah

(D.C. No. 93-CV-68, 93-CV-317, 93-CV-424)

Before TACHA and HOLLOWAY, Circuit Judges, and BURRAGE,* District Judge.

TACHA, Circuit Judge.

I. Background

CF&I Fabricators of Utah, and various related entities (collectively, "CF&I") sponsored two qualified pension plans established for the benefit of their employees and retirees. Under the plans, CF&I was obligated to make annual plan funding contributions. On September 15, 1990, CF&I failed to make a required $12.4 million plan funding payment for the year ending December 31, 1989. Two months later, CF&I petitioned for reorganization under Chapter 11 of the Bankruptcy Code. The larger of the two pension plans was subsequently terminated by the Pension Benefit Guaranty Corporation ("PBGC"), a wholly-owned government corporation that guarantees payment of certain pension benefits. *See* 29 U.S.C. §§ 1321-1322b.[1]

The Internal Revenue Service ("IRS") filed several proofs of claim in the bankruptcy court. The claim that is the subject of this appeal arises under Internal Revenue Code ("IRC") section 4971(a), under which the IRS imposes a ten percent tax on the "accumulated funding deficiency" of specified pension plans. 26 U.S.C. § 4971(a). CF&I's failure to make the required pension plan contribution on September 15, 1990, triggered the immediate imposition of the tax. *See id.* The parties do not dispute CF&I's underlying section 4971 liability. At issue is what, if any, priority the claim should be accorded.

In its proof of claim, the IRS asserted that CF&I's section 4971(a) liability was entitled to priority as an excise tax under Bankruptcy Code section 507(a)(7) (now codified at 11 U.S.C. § 507(a)(8)).[2] The bankruptcy court disagreed with the IRS's position and held that CF&I's section 4971(a) liability was not an excise tax. Instead, the court characterized the claim as a penalty that did not compensate for pecuniary loss and was therefore not entitled to priority status. *In re CF&I Fabricators*, 148 B.R. 332, 337-40 (Bankr. D. Utah 1992). In a subsequent order, the bankruptcy court subordinated the IRC section 4971(a) claim to all other general unsecured claims pursuant to the Bankruptcy Code's equitable subordination provision, 11 U.S.C. § 510(c)(1). The district court affirmed the bankruptcy court's orders, and the government appealed to this court. We have jurisdiction pursuant to 28 U.S.C. §§ 1-58(d) and 1291.

In its appeal, the IRS argues that the bankruptcy and district courts erred (1) by concluding that the

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* The Honorable Michael Burrage, District Judge, United States District Court for the Eastern District of Oklahoma, sitting by designation.

[1] Most of the funds from which the PBGC pays pension benefits come from insurance premiums paid by sponsors of qualified pension plans. *See* 29 U.S.C. § 1305. The PBGC filed proofs of claims against the debtors in the bankruptcy court. The bankruptcy court ruled that these claims are unsecured and are not entitled to priority or administrative status. That ruling is not at issue in this appeal.

[2] Congress amended section 507 on October 22, 1994. Former subsection 507(a)(7) is currently located at subsection 507(a)(8). Other than the change in priority of governmental claims, the text of the subsection is unchanged. In this opinion we will refer to the provision as it was codified at the time the IRS asserted its claim.

exaction imposed by IRC section 4971(a) was not entitled to priority under section 507(a)(7), and (2) by subordinating the IRS's claim to all other unsecured creditors under the doctrine of equitable subordination. In addition, the government suggests that we reconsider, in an en banc hearing, our decision in *United States v. Dumler (In re Cassidy)*, 983 F.2d 161 (10th Cir. 1992).

II. Discussion

We review determinations of law by the bankruptcy court de novo. *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1536 (10th Cir. 1990). Our review of the district court's order affirming the bankruptcy court is de novo as well. *Burden v. United States (In re Burden)*, 917 F.2d 115, 116 (3d Cir. 1990).

A. *Priority Under Section 507(a)(7)*

The IRS contends that CF&I's section 4971(a) liability is a governmental claim entitled to priority under subsection 507(a)(7)(E) or, in the alternative, subsection 507(a)(7)(G). Section 507(a)(7)(E) accords priority to "an excise tax on . . . a transaction occurring before the date of the filing of the petition for which a return . . . is last due . . . after three years before the date of the filing of the petition." 11 U.S.C. § 507(a)(7)(E)(i). The same priority is accorded to "a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss." *Id.* § 507(a)(7)(G). The tax at issue here, IRC section 4971(a), is included in Subtitle D of the IRC, entitled "Miscellaneous Excise Tax." The IRS argues that, because the tax is

labeled an "excise tax" under the IRC, it must be considered an excise tax under the Bankruptcy Code as well.

On December 7, 1992, after the bankruptcy court issued its first order in this case, we decided *Cassidy*, 983 F.2d 161. In *Cassidy*, we held that "Congress' labeling of [an] exaction as a tax is not determinative of its status for priority in bankruptcy." *Id.* at 163. The tax at issue in *Cassidy* was the ten percent additional tax imposed by 26 U.S.C. § 72(t) on early distributions from qualified retirement plans. Section 72 is in subtitle A, chapter 1, subchapter B, part II of the IRC, which is titled "Items Specifically Included in Gross Income." Thus, the government argued, it should be given priority under section 507(a)(7)(A) as "a tax on or measured by income." We disagreed with the government and held that the label given a tax in the IRC was not determinative of its status for priority under section 507(a)(7). *Cassidy* further held that, to determine whether an exaction is a tax or penalty for priority in bankruptcy purposes, we apply the four-part test from *In re Lorber Indus.*, 675 F.2d 1062 (9th Cir. 1982). *Cassidy*, 983 F.2d at 163.

In the present case, the government vigorously argues that *Cassidy* was wrongly decided, again contending that a court should defer to Congress's designation of an exaction rather than look beyond the statutory label to the nature of the exaction. *Cassidy* binds this panel, however, because it is the law of this circuit. *See In re Smith*, 10 F.3d 723, 724 (10th Cir. 1993) (per curiam) ("We are bound by the precedent of prior panels absent en banc reconsideration or a superseding contrary decision by the Supreme Court."), *cert. denied*, 115 S. Ct. 53 (1994).

We therefore conclude that the bankruptcy court correctly refused to treat the IRC's label as determinative for priority in bankruptcy purposes.

Instead, the bankruptcy court looked beyond the IRC'c label and analyzed the nature of the exaction using the *Lorber* test. The court concluded that CF&I's section 4971(a) liability was not entitled to priority. We agree with the bankruptcy court's analysis and therefore affirm the order of the district court for substantially the reasons given by the bankruptcy court. *See In re CF&I Fabricators*, 148 B.R. 332.

B. *Equitable Subordination*

The government's first argument against equitable subordination of its claim is that a bankruptcy court may not subordinate a claim under section 510(c)(1) if that claim is entitled to priority under section 507. Because we have determined that the IRS's claim here is a nonpecunitry loss penalty not entitled to section 507 priority, we need not discuss the merits of this argument.

The government next contends that the phrase "under principles of equitable subordination" in section 510(c) prohibits the bankruptcy court from subordinating a claim without a finding of misconduct on the part of the subordinated claimant. In this case, the bankruptcy court expressly found that "there [had] been no inequitable conduct on the part of the Internal Revenue Service."

The Bankruptcy Code neither defines the doctrine of equitable subordination, *see United States v. Noland*, No. 93-4311, 1995 WL 82886, at *4 (6th Cir. Mar. 2, 1995), nor specifies the circumstances under

which it should be imposed, *see United States Abatement Corp. v. Mobil Exploration & Producing U.S., Inc. (In re United States Abatement Corp.)*, 39 F.3d 556, 561 (5th Cir. 1994). Consequently, courts applying section 510(c)(1) have looked to common law principles for guidance. *See, e.g., id.*

In general, equitable subordination is imposed only when a creditor has committed some kind of wrongful conduct. *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir. 1990); *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977). Nevertheless, the four circuit courts that have considered the matter have concluded that a court may subordinate a nonpecuniary loss tax penalty claim without a showing of misconduct on the part of the government. *See Noland*, 1995 WL 82886, at *8-9; *Burden*, 917 F.2d at 118-19; *Schultz Broadway Inn v. United States*, 912 F.2d 230, 234 (8th Cir. 1990); *In re Virtual Network*, 902 F.2d at 1249-50.[3]

The question was addressed first by the Seventh Circuit in *Virtual Network*. After a thorough analysis of the legislative history of section 510(c)(1), the court decided that Congress intended courts to continue developing the principles of equitable subordina-

[3] In addition, a number of district and bankruptcy courts have subordinated nonpecuniary loss tax penalties under section 510(c)(1). *See, e.g., In re Juvenile Shoe Corp. of Am.*, 166 B.R. 404, 410 (Bankr. E.D. Mo. 1994); *Walker v. Ferguson (In re Import & Mini Car Parts, Ltd.)*, 136 B.R. 178, 182 (Bankr. N.D. Ind. 1991); *Retail Marketing Corp. v. United States (In re Mako, Inc.)*, 135 B.R. 902, 904 (E.D. Okla. 1991); *Seidle v. United States (In re Airlift Int'l Inc.)*, 120 B.R. 597, 601-02 (S.D. Fla. 1990); *In re Merwede*, 84 B.R. 11, 14 (Bankr. D. Conn. 1988).

tion. *Virtual Network*, 902 F.2d at 1249-50. The court further found that "[section] 510(c)(1) authorizes courts to equitably subordinate claims to other claims on a case-by-case basis without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors." *Id.* at 1250.

In subsequent cases addressing this issue, other courts have employed substantially the same analysis as the *Virtual Network* court. *See Noland*, 1995 WL 82886, at *3-8; *Burden*, 917 F.2d at 116-20; *Schultz Broadway Inn*, 912 F.2d at 231-34. We find the reasoning of *Virtual Network* persuasive and hold that section 510(c)(1) does not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims.

The bankruptcy court considered the equities in this case and determined that subordination of the IRS's section 4971 claim to all other unsecured claims was appropriate. After noting that the facts in the case were undisputed, the bankruptcy court observed that general unsecured creditors of CF&I will receive only a small percentage of their claims. One of CF&I's unsecured creditors is the PBGC, which will be paying the pension benefits due under CF&I's terminated pension plan. Declining to subordinate the IRS's penalty claim would harm innocent creditors rather than punish the debtor for failing to fund the pension plan. Thus, the bankruptcy court reasoned, allowing the IRS's penalty claim would not advance the purposes of either IRC section 4971 or the Bankruptcy Code. We conclude that the bankruptcy court correctly addressed the equities in this case and therefore affirm the orders subordinating the IRS's section 4971 claims.

III. Conclusion

For the reasons stated in this opinion, the judgment of the district court is AFFIRMED. In addition, the government's suggestion for hearing en banc to reconsider our decision in *In re Cassidy*, 983 F.2d 161, has been brought to the attention of all the active judges of the court. As no poll has been requested on the suggestion, it is hereby DENIED.

APPENDIX B

[Filed Nov. 24, 1993]

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Consolidated Appeals
Civil No. 93C-068W
Civil No. 93C-317S
Civil No. 93C-424W

IN RE: CF&I FABRICATORS OF UTAH, INC., DEBTORS

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND CO., REORGANIZED KANSAS METALS CO., REORGANIZED ALBUQUERQUE METALS CO., REORGANIZED PUEBLO METALS CO., REORGANIZED PUEBLO RAILROAD SERVICE CO., REORGANIZED DENVER METALS CO., REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORP., REORGANIZED THE COLORADO AND WYOMING RAILWAY CO., PLAINTIFFS/APPELLEES

vs.

THE UNITED STATES OF AMERICA,
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE, DEFENDANT/APPELLANT

ORDER

These appeals came on for oral argument before the Court on November 23, 1993. For the reasons stated by the Court in its findings and conclusions made on the record, which are incorporated herein, the decisions of the Bankruptcy Court which are the subject of these appeals are affirmed.

DATED this 23d day of November, 1993.

/s/ David K. Winder
DAVID K. WINDER
United States District Judge

APPROVED AS TO FORM:

/s/ Steven J. McCardell
STEVEN J. MCCARDELL

/s/ Kirk Lusty
KIRK LUSTY

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Case No. 93-C-068W
93-C-317S
93-C-424W

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND CO., REORGANIZED KANSAS METALS CO., REORGANIZED ALBUQUERQUE METALS CO., REORGANIZED PUEBLO METALS CO., REORGANIZED PUEBLO RAILROAD SERVICE CO., REORGANIZED DENVER METALS CO., REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORP., REORGANIZED THE COLORADO AND WYOMING RAILWAY CO., PLAINTIFFS/APPELLEES

vs.

THE UNITED STATES OF AMERICA,
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE, DEFENDANT/APPELLANT

TRANSCRIPT OF ARGUMENT ON
BANKRUPTCY APPEAL
BEFORE THE HONORABLE DAVID K. WINDER
UNITED STATES DISTRICT JUDGE
November 23, 1993

[3] **PROCEEDINGS**

November 23, 1993

THE COURT: All right. We're here in these three consolidated appeals, and this is Number 93-C-68W, 93-C-317S and 93-C-424W. And this involves the debtor, which is Reorganized C.F.&I. Fabricators.

And, let's see, it's Mr. Waterman?

MR. McCARDELL: Mr. McCardell, Your Honor.

THE COURT: I'm sorry. Mr. Steven J. McCardell is here representing The Reorganized C.F.&I. Fabricators of Utah, and Mr. Kirk C. Lusty is here representing the U.S.A.

And I've read carefully your memos. I appreciate your being here on time. I've got to resume a jury trial at 9:00 o'clock, and I would ask you to take a maximum of 15 minutes a side.

I have read Judge Boulden's decision. I've read your memos carefully. I read the In Re Cassidy Tenth Circuit, the Mansfield case, and so I'm pretty familiar with what's involved here.

Mr. Lusty.

MR. LUSTY: Your Honor, I do realize you have a jury trial. And I realize, you know, I like you have several times read Cassidy and Mansfield Tire. We think the Mansfield Tire is the correct logic, but I realize the position the [4] court's in—

THE COURT: I don't overrule the Tenth Circuit. They ruled on 26(T), but there to me—what's the difference between the ten percent penalty on taking out your pension prematurely and 4791(A)?

MR. LUSTY: Well, the difference there, not talking about how broad the Cassidy opinion is, is that on the—on taking it out it's just a penalty for with-

drawal, and I thing pretty much you get into the legislative history and the statute, and at times they refer to it as a penalty, other times a tax.

Here it's—the pension excise, at least the first tier penalty, is always referred to as a tax. And basically when you fill out the form that's to accompany payment, you know, you look and what you haven't paid you list a ten percent penalty, almost like a—or ten percent tax I should say, much like, oh, on your income tax return, underreporting or underpayment, there's just a penalty.

It's associated with the return. It goes in different —for instance, you'll notice that in this appeal we don't, although Judge Boulden ruled against us, deal with the second tiered penalties, which are I think much more closer to penalties.

The first tier is, you know, reported on a return. It's figured, self-reported, that type of thing. There's —I.R.S. [5] is generally less involved in the audit assessment process with the first tier tax.

Before I go on with that, Your Honor, I guess the simplest way to proceed—because I do realize the time pressures on the court—Cassidy is a very broad opinion, and it doesn't purport to limit itself to the tax penalty that was raised in—in that particular case, a different penalty here, but it does specifically discuss Mansfield.

THE COURT: And rejects it.

MR. LUSTY: And rejects it. Is there anything I could convince or add to that that would help the court in that area.

THE COURT: I really don't. And to give you the bad news, Mr. Lusty, and I think you better get up to the circuit, if you're going there, pretty fast, because I denied the stay back in January. I guess

the reorganization, I don't know what's going on, but it seems to me if you're going to appeal this, you better do it quickly, and I notice Judge Boulden moved pretty swiftly in the bankruptcy court.

But Idon't see there's any distinguishing factor with Cassidy. Cassidy didn't rule on the 510(C) of the code, the equitable subordination thing, but I think frankly that follows, and I'm inclined to affirm the bankruptcy court.

MR. LUSTY: Okay. Let me, to enlighten that, discuss simply for a moment the equitable subordination issue, [6] because it is a very similar argument. Mansfield did, of course, involve equitable subordination, and Cassidy didn't; of course, Cassidy being a different type of tax didn't really need to get into that, or a much smaller amount.

And as we've discussed in our brief, the equitable subordination issue we submit early involved basically cases where there was credit or misconduct. Judge Boulden specifically stated in this case that there wasn't any.

Since in the last few years there have been cases, the virtual network and so forth, that have come down that at least have ruled or appear to rule that equitable misconduct is not the sole ground and you can do a—subordinate without equitable misconduct. We think, quite frankly, that they're misinterpreting the law, but nevertheless that's where they are.

We think the same distinction, and in light of Cassidy, there is some concern, but Cassidy didn't address it, that where it is a tax, that the subordination Moore is talking about penalties and so forth. And so that the court should make the same distinction as Mansfield Tire made and not subordinate

where it is a tax, and we think that's going further than the bankruptcy court should.

I realize that's very close to the same logic that Cassidy, if not the same logic, Cassidy rejected, but as we've set forth in our brief—

[7] THE COURT: You hadn't of course, read —the Tenth Circuit decided Cassidy December 7, of '92.

MR. LUSTY: Yes.

THE COURT: And you had read Judge Weinshank and Judge Clark, is it, in the bankruptcy court—

MR. LUSTY: In Colorado, yes.

THE COURT: But the Tenth Circuit opinion, of course, was not available to Judge Boulden when she decided that case.

MR. LUSTY: No. She had already decided. And I don't think, quite frankly, it would—obviously the same analysis she rejected and accepted, it seems like she essentially—you know, they're essentially the same. I don't want to take more of the court's time—

THE COURT: You're not taking my time. It's just you've got an uphill battle here, Mr. Lusty.

MR. LUSTY: I appreciate that.

THE COURT: I know you know that.

MR. LUSTY: Is there anything I can add on the subordination? Because that's it in a nutshell, that this is a tax, Congress has called it a tax—

THE COURT: I know.

MR. LUSTY: —and it should be not subordinated, and in this case that subordination essentially means the taxpayers bear the full brunt of this decision.

[8] I don't—really don't think there's anything I can add, unless—

THE COURT: Yes. You say the taxpayers bear the brunt. I mean this—I think this is a penalty. I don't know that the taxpayers are bearing any brunt. What's the reverse of this are these general creditors are going to take gas. I mean if you take 1,241,000 out of here, I guess there isn't a cent for anybody else.

MR. LUSTY: Well, in terms of this case, maybe, maybe not. Money has been set aside to pay other taxes if they're determined to be due; for instance, corporate income tax and others. And to the extent there will be—should be funds if—in the long-run if the United States were to prevail and happened to lose—particularly if it happened to lose on other taxes. In the long-run though if the United States gets it, I think it's fair to say that some other creditor wouldn't receive it—no question.

THE COURT: Thank you, Mr. Lusty, very much. Do you want to say anything, Mr. Mc Cardell?

MR. Mc CARDELL: Your Honor, I'm not one to argue myself out of court, and so I don't want to say anything Your Honor doesn't want to hear. I can answer your question with regard to Section 72(t) because that is a point of consideration since the Tenth Circuit did not directly rule on the 4971 tax.

[9] THE COURT: Yes. I think I said 4791—4971, and you're of course right.

MR. Mc CARDELL: The two points of distinction that the service raised in their brief are, number one, that the tax is self-assessing and, number two, that the notice of deficiency procedure applies to the Section 72(t) tax.

In reviewing those sections of the Internal Revenue Code though, Your Honor, it's apparent to me

that the same is true of the taxes ruled on in the Cassidy case. In other words, Section 72(t) is also self-assessing and the circuit's opinion said so, and this notice of deficiency procedures applies just the same. So that in substance we're dealing with the exact issue, and so I believe the service must seek their leave from the Supreme Court on this issue to get the law changed.

THE COURT: Okay, thank you. I affirm the Bankruptcy Court, and I hold that Section 4971(a) tax claim for 1989 is a nonpecuniary loss penalty, not a tax. It's not entitled to priority status pursuant to 507(A)(7) of the Bankruptcy Code, and I further hold that it's a claim that should be equitably subordinated to the claims of the general creditors under Section 510(c) of the code, and I do this primarily based on the In Re Cassidy case at 983 Fed. 2nd 161 decided by the Tenth Circuit last December.

Thank you very much. Prepare an order, Mr. Mc Cardell, and get it to me.

[10] MR. Mc CARDELL: I'll do that.

THE COURT: Thank you, gentlemen.

MR. LUSTY: Thank you.

(Hearing concluded at 8:40 a.m.)

APPENDIX D

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH CENTRAL DIVISION

Jointly Administered
Under Case No. 90B-6721

Chapter 11

Adversary Proceeding No. 92PB-2395

IN RE: CF&I FABRICATORS OF UTAH, INC., ET AL.,
DEBTORS

CF&I FABRICATORS OF UTAH, INC., ET AL.,
PLAINTIFFS

vs.

UNITED STATES OF AMERICA,
Department of the Treasury,
Internal Revenue Service, DEFENDANT

ORDER GRANTING DEBTORS' MOTION FOR SUMMARY JUDGMENT (DATED 12/22/92) AND SUBORDINATING ALL CLAIMS OF THE INTERNAL REVENUE SERVICE ARISING OUT OF 26 U.S.C. § 4971 TO ALL OTHER UNSECURED CLAIMS

The Debtors' Motion for Summary Judgment (Dated 12/22/92) (the "Motion") came on for hearing before the Court at 10:00 a.m. on Thursday, January 28, 1993. Steven C. Strong of LeBoeuf, Lamb, Leiby & MacRae appeared on behalf of CF&I Fabricators of Utah, Inc. and nine other related debtors whose bankruptcy cases are being jointly administered by this Court under Case No. 90B-6721 (collectively the "Debtors"). Steven T. Waterman of Ray, Quinney & Nebeker appeared on behalf of the Unsecured Creditors' Committee (the "Committee"). Mark Howard, Special Assistant United States Attorney, appeared on behalf of the Internal Revenue Service.

Having considered (i) the Motion, (ii) the Memorandum in Support of the Motion, (iii) the Memorandum of the United States in Opposition to the Motion, (iv) the Reply Memorandum in Support of the Motion, and (v) this Court's Order granting the Committee's intervention as a party plaintiff in this proceeding, the Court announced certain findings of fact and conclusions of law in open court (the "January 28th Ruling"), which Ruling is incorporated herein by this reference. Pursuant to the findings and conclusions contained in the January 28th Ruling.

IT IS HEREBY ORDERED AND ADJUDGED as follows:

1. The Debtors' Motion shall be and hereby is GRANTED, and judgment is entered in favor of the plaintiffs on all causes of action in the Debtors' Verified Complaint (except that, as requested in the Motion, the Court reserves judgment on that portion of the Complaint which seeks to subordinate claims to interests of CF&I Steel Corporation in its subsidiaries).

2. The claims of the IRS based on 26 U.S.C. § 4971(a) for the year ended December 31, 1989 and subsequent years are subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c).

3. The claims of the IRS based on 26 U.S.C. § 4971(b) for the year ended December 31, 1989 and any subsequent years are subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c).

4. The claims of the IRS for late payment penalties are subordinated to the claims of all other unsecured general creditors of the Debtors pursuant to 11 U.S.C. § 510(c).

DATED this 9 day of March, 1993.

BY THE COURT:

/s/ ______________________________

HONORABLE JUDITH A. BOULDEN
United States Bankruptcy Judge

APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH CENTRAL DIVISION

Jointly Administered
Under Case No. 90B-6721

Chapter 11

IN RE: CF&I FABRICATORS OF UTAH, INC., ET AL.,
DEBTORS

(Case No. 90B-6721)
(Case No. 90B-6722)
(Case No. 90B-6723)
(Case No. 90B-6724)
(Case No. 90B-6725)
(Case No. 90B-6726)
(Case No. 90B-6727)
(Case No. 90B-6728)
(Case No. 90B-6729)
(Case No. 90B-6730)

(CF&I FABRICATORS OF UTAH, INC.) (COLORADO & UTAH LAND COMPANY) (KANSAS METALS COMPANY) (ALBUQUERQUE METALS COMPANY) (PUEBLO METALS COMPANY) (DENVER METALS COMPANY) (PUEBLO RAILROAD SERVICE COMPANY) (CF&I FABRICATORS OF COLORADO, INC.) (CF&I STEEL CORPORATION) (THE COLORADO AND WYOMING RAILWAY COMPANY)

ORDER CONFIRMING DEBTORS' AND RAILROAD TRUSTEE'S FIRST AMENDED AND RESTATED JOINT PLAN OF REORGANIZATION DATED DECEMBER 1, 1992

On January 27, 1993, the Court held a hearing to consider confirmation of the Debtors' and Railroad Trustee's First Amended and Restated Joint Plan of Reorganization dated December 1, 1992, a copy of which is attached to this Order as Exhibit 1 (the plan, together with the following modifications is referred to as the "Plan"), and the sale thereunder of those assets described in an Asset Purchase Agreement among Debtors (other than Kansas Metals Company), William J. Westmark, as trustee for the bankruptcy estate of The Colorado and Wyoming Railway Company (the "Railroad Trustee"), CF&I Steel, L.P. (formerly known as and identified in the Plan as New CF&I Limited Partnership), New CF&I, Inc., and Oregon Steel Mills, Inc. (a copy of the Asset Purchase Agreement is attached to the Plan as Exhibit B).

At the hearing, the Debtors and Railroad Trustee proposed the following modifications to the Plan and the Court determined pursuant to Bankruptcy Rule 3019 that the proposed modifications do not adversely change the treatment of the claim of any creditor or the interest of any equity security holder who has not accepted in writing the modification:

a. *Provisions concerning objection to Plan filed by IRS.*

i. Federal tax claims entitled to administrative priority must be filed by the Internal Revenue Serv-

ice ("IRS") not later than 180 days following the later of (1) the Effective Date or (2) the date a tax return is filed for a tax year or tax period. The IRS may request additional time to file any such claim as the Bankruptcy Court, for cause shown, permits; and

ii. Paragraphs 60 and 61 of the Plan shall not apply to any claims of the IRS against officers and directors for withholding taxes pursuant to section 6672 of the Internal Revenue Code; and

iii. Paragraph 61 of the Plan applies only to claims for which, pursuant to paragraph 60 of the Plan, indemnification obligations of the Debtors survive unaffected by the reorganization contemplated by the Plan; and

iv. Paragraph 70a(3)(iv) of the Plan (as reflected below in this Order) is modified to insert the words "for any Claims" in paragraph 70a(3)(iv) between the words "liability" and "by;" and

v. On the Effective Date, pursuant to the Plan's provisions for the treatment of Class 16, CF&I Steel Corporation's stock in each of its subsidiaries shall be canceled; and

vi. CF&I Steel Corporation shall, on the Effective Date of the Plan, pay to the United States Internal Revenue Service all amounts received after the date of the commencement of these cases by way of refunds of fuel excise taxes, and the United States Internal Revenue Service shall be authorized to apply such funds, plus any refunds of fuel excise taxes not distributed to CF&I Steel Corporation as of the Effective Date of the Plan, to post-petition alternative minimum tax claims of the Internal Revenue Service.

b. *Provisions concerning objection to Plan filed by Salt Lake County.* The Claim of Salt Lake County against CF&I Fabricators of Utah, Inc., which includes a secured claim for a penalty in the amount of $220.57, is an Allowed Secured Claim to be treated in Class 4 under the Plan.

c. *Provisions concerning objection to Plan filed by State of Colorado, Division of Labor.* Debtors shall continue payments in the ordinary course of their businesses, through the Effective Date on account of workers' compensation claims but, after the Effective Date, shall discontinue all such payments. With respect to Debtors with employees in Colorado, the Division of Labor of the State of Colorado shall designate, on or before the Effective Date, a successor administrator to receive delivery of documents and information concerning Debtors' present known, and potential Colorado workers' compensation claims, such administrator to administer said workers' compensation claims and to continue such payments thereon.

d. *Provisions concerning objection of Debtors to certain claims of PBGC.* Debtors' objections to the Claims of the Pension Benefit Guaranty Corporation as to the Non-Contributory Pension Plan of CF&I Steel Corporation shall be suspended pending the Debtors' and the Reorganization Debtors' implementation of Paragraph 56 of the Plan. Upon completion of a standard termination of the Non-Contributory Pension Plan of CF&I Steel Corporation in accordance with Section 4041(b) of ERISA, PBGC's Claims as to the Non-Contributory Pension Plan of CF&I Steel Corporation shall be deemed satisfied in full, and the Debtors objections thereto shall be deemed withdrawn. In the event the standard termi-

nation cannot be completed and the Debtors and the Reorganized Debtors decide to press the objection, they shall notify PBGC in writing and PBGC shall have thirty (30) days to respond.

e. *Provisions concerning Coastal Gas contract.* CF&I Steel Corporation shall have until the Effective Date to assume or reject its gas supply contract with Coastal Gas Marketing. The bar date for Coastal Gas Marketing to file any claims arising from any rejection of such contract shall be thirty (30) days after the Effective Date. If such contract is assumed, Coastal Gas Marketing shall have no remaining claim against the Debtors.

f. *Paragraph 70(a)(2) of Plan.* The conditions set forth in Paragraph 70a(2) of the Plan has been waived.

The Court then considered confirmation of the Plan as modified by paragraphs a through f above. Based on evidence presented at the hearing, the papers contained in the dockets of these cases on file with the Court, and the arguments of counsel, the Court made certain findings and conclusions on the record in addition to those findings and conclusions set forth below, which findings and conclusions are incorporated by this reference. Now, therefore, the Court finds as follows:

1. *Notice.* Notice of parties in interest of the time fixed for filing objections and the hearing to consider confirmation of the Plan has been given and is sufficient pursuant to applicable law. The solicitation package with respect to the Plan as approved by the Court was properly served on all necessary parties. Debtors have satisfied their obligations with respect to service of the solicitation package.

2. *Acceptance.* The balloting process on the Plan has been proper and the Plan has been accepted in writing by the creditors and equity security holders whose acceptance is required by law.

3. *Objections to Confirmation.* All objections to Confirmation, including without limitation those stated by way of letters to the Court, have been considered by the Court and have been overruled or withdrawn.

4. *Plan Conditions to Confirmation.* All conditions to Confirmation set forth in the Plan have been satisfied or effectively waived.

5. *Section 1129(a)(1).* The Plan complies with the applicable provisions of the Bankruptcy Code, including without limitation the provisions of the Bankruptcy Code respecting classification of Claims and the requirements of Bankruptcy Code section 1123. The Court specifically finds that Classes 1 and 11 are appropriate classes.

6. *Section 1129(a)(2).* The Plan Proponents have complied with the applicable provisions of the Bankruptcy Code.

7. *Section 1129(a)(3).* The Plan has been proposed in good faith and not by any means forbidden by law.

8. *Section 1129(a)(4).* All payments made or promised by the Debtors or by a person issuing securities or acquiring property under the Plan or by any other person for services or for costs and expenses in, or in connection with, the Plan and incident to the cases, have been fully disclosed to the Court and are reasonable or, if to be fixed after confirmation of the Plan, will be subject to approval of the Court.

9. *Section 1129(a)(5).* The identity, qualifications, and affiliations of the persons who are to be the directors or officers, or voting trustees, if any, of the Debtors after confirmation of the Plan have been fully disclosed, and the appointment of such persons to such offices, or their continuance therein, is equitable, and consistent with the interests of creditors and equity security holders and with public policy; and the identity of any insider that will be employed or retained by the Debtors and the nature of his compensation have been fully disclosed.

10. *Section 1129(a)(6).* The Plan does not propose any changes of rates under the jurisdiction of any regulatory commission and the rates of The Colorado and Wyoming Railway Company will continue to be regulated by such regulatory authorities as have jurisdiction under applicable nonbankruptcy law.

11. *Section 1129(a)(7) and Section 1129(a)(8).* Each holder of a claim or interest has accepted the Plan or will receive or retain under the Plan property of a value, as of the Effective Date of the Plan, that is not less than the amount that such holder would receive or retain if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code on such date; or the Plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the Plan.

12. *Section 1129(a)(9).* Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the Plan satisfies the requirements of Bankruptcy Code Section 1129(a)(9) with respect to the payment of Claims having priority under Bankruptcy Code Section 507.

13. *Section 1129(a)(10).* For each Debtor, at least one class of claims that is impaired under the Plan has accepted the Plan, determined without including any acceptance of the Plan by any insider.

14. *Section 1129(a)(11).* Confirmation of the Plan is not likely to be followed by the liquidation or the need for further reorganization of the Debtors except as provided in the Plan.

15. *Section 1129(a)(12).* All fees payable under 28 USC § 1930, as determined by the Court at the hearing on confirmation of the Plan have been or will be paid on the Effective Date of the Plan.

16. *Section 1129(a)(13).* Class 1 and each subclass thereof have accepted the Plan. The level of retiree benefits has not been modified during the period of reorganization, and therefore subsections (e)(1)(B) and (g) of Section 1114 of the Bankruptcy Code have not been invoked and section 1129(a)(13) is not applicable.

17. *Section 1173(a).* With respect to The Colorado and Wyoming Railway Company,

a. All applicable requirements of Bankruptcy Code section 1129 have been met; and

b. Each creditor or equity security holder will receive or retain under the Plan property of a value, as of the Effective Date of the Plan, that is not less than the value of property that each such creditor or equity security holder would so receive or retain if all of the operating lines of the debtor were sold, and the proceeds of such sale, and the other property of the estate, were distributed under Chapter 7 of the Bankruptcy Code on such date; and

c. In light of the debtor's past earnings and the probable prospective earnings of the reorganized debtor, there will be adequate coverage by such pro-

spective earnings of any fixed charges, such as interest on debt, amortization of funded debt, and rent for leased railroads, provided for by the Plan; and

d. The Plan is consistent with the public interest.

18. *Sales of Assets under Asset Purchase Agreement.* Notice satisfying the provisions of Bankruptcy Code Section 363(b)(1) of the Bankruptcy Code that the Debtors and the Railroad Trustee intend to sell those assets described in the Asset Purchase Agreement, attached as Exhibit B to the Plan, was provided to all parties in interest on or about December 22 and 23, 1992, as part of the solicitation package sent to parties in interest.

19. *Clayton Act Notices.* Debtors have advised the Court that they have given all notices of the sale as required by subsection (a) of Section 7A of the Clayton Act in accordance with Bankruptcy Code Section 363(b)(2).

20. *Purchase Price and Satisfaction of Liens.* All entities which hold interests in the assets to be sold, other than the bankruptcy estates, are holders of liens and such entities will receive money in satisfaction of the interest that they hold therein; and the price at which the assets are to be sold is greater than the aggregate value of all liens on such assets. The purchase price provided in the Asset Purchase Agreement is fair consideration for the assets being purchased.

21. *Good Faith of Buyer.* The Buyer, as defined in the Asset Purchase Agreement, is a good faith purchaser within the meaning of Bankruptcy Code section 363(m).

NOW, THEREFORE, it is hereby
ORDERED:

1. *Approval of Modifications.* The modifications to Debtors' and Railroad Trustee's First Amended and Restated Joint Plan of Reorganization Dated December 1, 1992 proposed in paragraphs a through f above are approved.

2. *Confirmation of Plan.* Debtors' and Railroad Trustee's First Amended and Restated Plan of Reorganization, Dated December 1, 1992, as modified by this Order, is confirmed and all objections to the confirmation of the Plan are overruled.

3. *Authorizations for Asset Purchase Agreement.* Debtors and the Railroad Trustee are authorized to execute, deliver, and perform their respective obligations under an Asset Purchase Agreement in form substantially similar to the Asset Purchase Agreement attached as Exhibit B to the Plan as amended on January 27, 1993 and to execute any and all other documents and to take any and all actions necessary to complete the asset purchase and sale and upon its execution and delivery by all parties thereto, the Asset Purchase Agreement shall be valid, binding upon and enforceable against the Debtors and the Railroad Trustee.

4. *Authorizations for Implementation of Plan.* Debtors, the Reorganized Debtors, and the Railroad Trustee are authorized to execute any and all other documents and to take any and all actions necessary to implement the Plan.

5. *Retention of Property.* Except as otherwise expressly provided in this Order, each Debtor's estate shall retain all the property of its estate dealt with by the Plan free and clear of all Claims, liens, encumbrances, charges, and other interests of creditors and equity security holders, except as provided in the

Plan or this Order and each Debtor and Reorganized Debtor shall perform its obligations under the Plan.

6. *Transfers of Assets.* The transfers of assets pursuant to the Asset Purchase Agreement by the Debtors to CF&I Steel, L.P. (or such other entity purchasing such assets pursuant to the Asset Purchase Agreement or designated by CF&I Steel, L.P., to receive such assets), and pursuant to the Plan by the Debtors to Reorganized CF&I Steel Corporation when made (i) will be legal, valid and effective transfers of such assets; (ii) will vest CF&I Steel, L.P., or Reorganized CF&I Steel Corporation's estate or such other entity purchasing such assets pursuant to the Asset Purchase Agreement or the Plan with good title to such assets free and clear of all liens, charges, claims, encumbrances, or interests; (iii) do not and will not constitute fraudulent transfers or conveyances under the Bankruptcy Code or under the laws of the United States, any state, territory, possession or in the District of Columbia; (iv) will not subject Oregon Steel Mills, Inc., New CF&I, Inc., CF&I Steel, L.P. (or any of their affiliates) or Reorganized CF&I Steel Corporation to any liability for any Claims from any creditors of the Debtors and the Railroad Trustee, including, without limitation, any Claims under the Coal Industry Retiree Health Benefits Act of 1992 (including those filed or asserted by the 1992 United Mine Workers of America Benefit Plan and the United Mine Workers of America Combined Fund or the trustees thereof), by reason of such transfer under the laws of the United States, any state, territory, or possession thereof, or the District of Columbia based, in whole or in part, directly or indirectly, on any theory of law, including, without limitation, any theory of successor or transferee liability; and (v) all executory contracts, including, without limitation, product, patent, trademark, and know-how licenses and unexpired leases assumed by the Debtors and the Railroad Trustee during the Cases or under the Plan which are also assumed by CF&I Steel, L.P. pursuant to the Asset Purchase Agreement shall be assigned and transferred to, and remain in full force and effect for the benefit of, CF&I Steel, L.P., notwithstanding any provision in such contracts or leases (including those described in Sections 365(b)(2) and (f) of the Bankruptcy Code) that prohibit such assignment or transfer or that enables or requires termination of such contracts or leases based on the acquisition of assets pursuant to the terms of the Asset Purchase Agreement.

7. *Release.* Except as otherwise expressly provided in the Plan or in this Order, on the Effective Date all Persons (i) who have held, hold, or may hold Claims, or (ii) who have held, hold, or may hold CF&I Steel Corporation stock or stock of subsidiaries of CF&I Steel Corporation, in consideration for the obligations of the Debtors under the Plan, will be deemed to have forever waived, released, and discharged all rights or Claims, whether based upon tort, fraud, contract or otherwise, which they heretofore, now or hereafter possess or may possess against any of the Debtors.

8. *Injunction.* Except as otherwise expressly provided in the Plan or in this Order, all Persons who have held, or may hold Claims against or interests in any of the Debtors or liens against or interests in property of the Debtors or of any of the Debtors' estates are permanently enjoined on and after the Confirmation Date from taking any of the following

actions against the Debtors, the Railroad Trustee, the Reorganized Debtors, the Reorganized Creditors' Committee, CF&I Steel, L.P., New CF&I, Inc., or Oregon Steel Mills, Inc., or any of their officers, directors, agents, or affiliates or against any of the property of such entities with respect to such Claims or interests from: (a) commencing or continuing in any manner any action or other proceeding of any kind with respect to any such Claim or interest; (b) the enforcement, attachment, collection or recovery by any manner or means of any judgment, award, decree, or order; (c) creating, perfecting, or enforcing any lien or encumbrance of any kind; (d) asserting any setoff, right of subrogation, or recoupment of any kind against any obligation due to such entities; and (e) any act, in any manner, in any place whatsover, that does not conform to or comply with the provisions of the Plan.

9. *Validity of Sale Notwithstanding Reversal or Modification on Appeal.* The reversal or modification on appeal of the authorization to sell granted by this order shall not affect the validity of the sale under the Asset Purchase Agreement unless such authorization shall be stayed pending appeal.

10. *Claim of CF&I Steel, L.P. for Overpayment.* CF&I Steel, L.P. shall have a claim to any cash held by the Reorganized Debtors or the Railroad Trustee after the Effective Date for return of any overpayment as defined in Section 3.3(d) of the Asset Purchase Agreement. CF&I Steel, L.P.'s claim to such cash shall have a priority superior to all claims of general unsecured creditors in Classes 12, 13, and 14.

11. *VEBA Trust.* The VEBA Trust provided for in the Plan shall be established pursuant to a Trust

Agreement for CF&I Retiree Volunary Employees Beneficiary Association in substantially the form of Exhibit 10 received in evidence at the confirmation hearing, as modified during the hearing, and attached as part of Exhibit C to the Plan, which is attached as Exhibit 1 to this Order. On the Effective Date, pursuant to the Agreement for Substitution of Sponsors of the CF&I Retiree Voluntary Employee Beneficiary Association in substantially the form of Exhibit 11 received in evidence at the confirmation hearing and attached as part of Exhibit C to the Plan, which is attached as Exhibit 1 to this Order, CF&I Steel, L.P. shall succeed Debtors as sponsors of the CF&I Retiree Voluntary Employee Beneficiary Association, and the plan and trust established thereunder. The "Payment Recipient" identified in Section 3 of the Asset Purchase Agreement shall be the VEBA Trust provided for in the Plan.

12. *VEBA Trustees.* The initial trustees of the VEBA Trust provided for in the Plan shall be the following:

a. *Trustees selected by Debtors*: Robert W. Mac Cannon, Joan F. Vialpando, and Arthur L. Schwager.

b. *Trustees selected by the United Steelworkers of America*: Ray MacDonald, Dallas Alexander, and a representative of the Steelworker Organization of Active Retirees ("SOAR"), to be named by the United Steelworkers of America.

13. *Assumption, Assignment, and Rejection of Executory Contracts and Leases.* The assumption and assignment of those executory contracts and leases specified in Exhibit D to the Plan, a copy of which is attached to this Order as Exhibit 1, is ap-

proved and the rejection of all other executory contracts and leases as provided in the Plan is approved.

14. *Governance Provisions.* The provisions for governance of the Debtors and the Reorganized Debtors set forth in Exhibit 9 received in evidence at the confirmation hearing and attached as Exhibit 2 to this Order are hereby approved.

15. *Commitment Relating to Non-Contributory Pension Plan.* In order to effectuate the provisions of the Plan concerning the Non-Contributory Pension Plan of CF&I Steel Corporation, Debtors are authorized to enter into and make all commitments under the Agreement for Commitment to Make Plan Sufficient for Benefit Liabilities in substantially the form of Exhibit 3 to this Order.

16. *Distributions.* Distributions shall be made in the manner set forth in the Plan and as provided herein. As set forth in the Amended and Restated Agreement of Limited Partnership, the Pension Benefit Guaranty Corporation ("PBGC") shall be the limited partner of CF&I Steel, L.P. on the Effective Date of the Plan, with Debtors contributing partnership assets to CF&I Steel, L.P. on the Effective Date for the benefit of and on behalf of the PBGC in deemed distribution to it. Neither Debtors nor Reorganized Debtors shall be partners in CF&I Steel, L.P. The PBGC's limited partnership interest shall be subject to the obligation of PBGC to transfer all or such portion thereof as may be required in order to carry out the terms of the Plan, including to comply with the provisions of Paragraph 92 of the Plan and the provisions of the Plan for distributions to Class 12.

17. *Distribution of Certain Securities.* Distribution of the Deferred Stock Payment and the Five

Year Warrants (as those terms are defined in Section 3.1 of the Asset Purchase Agreement) to be delivered by Oregon Steel Mills, Inc., pursuant to the terms of the Asset Purchase Agreement, shall be made after the Effective Date, pursuant to an order of the Court, to the holders of any Allowed Claims entitled to such distributions under the Plan or as the Court may further order; provided, however, that Oregon Steel Mills, Inc., shall be obligated to issue the Deferred Stock Payment and the Five Year Warrants, only if the conditions in Section 10.15 of the Asset Purchase Agreement have been satisfied; and provided, further, that any such distribution shall comply with the provisions of Paragraph 92 of the Plan and the provisions of the Plan for distribution to Class 12, and shall take into account any transfer of the PBGC's limited partnership interest as may be required in the last sentence of the preceding paragraph 16 of this Order.

18. *Bar Dates Provided in Plan.* All bar dates provided in the Plan, as modified by this Order, shall be effective and Debtors shall give notice thereof with notice of this Order.

DATED: February 12, 1993.

/s/ Judith A. Boulden
JUDITH A. BOULDEN
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT COURT OF UTAH CENTRAL DIVISION

Jointly Administered Under
Under Case No. 90B-6721
[Chapter 11]

IN RE: CF&I FABRICATORS OF UTAH, INC., ET AL., DEBTOR

(Case No. 90B-6721)
(Case No. 90B-6722)
(Case No. 90B-6723)
(Case No. 90B-6724)
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(Case No. 90B-6729)
(Case No. 90B-6730)

(CF&I FABRICATORS OF UTAH, INC.) (COLORADO & UTAH LAND CO.) (KANSAS METALS COMPANY) (ALBUQUERQUE METALS COMPANY) (PUEBLO METALS COMPANY) (DENVER METALS COMPANY) (PUEBLO RAILROAD SERVICE CO.) (CF&I FABRICATORS OF COLORADO, INC.) (CF&I STEEL CORPORATION) (THE COLORADO AND WYOMING RAILWAY COMPANY)

MEMORANDUM DECISION AND ORDER RELATING TO DEBTORS' OBJECTIONS, DATED 10/02/92, FOR DISALLOWANCE AND DETERMINATION OF PRIORITY OF CLAIMS OF THE INTERNAL REVENUE SERVICE

On November 7, 1990, these related steel production companies (Debtors) filed petitions under chapter 11, primarily in an attempt to reorganize in light of their inability to fund two defined benefit pension plans. The United States of America, Department of the Treasury, Internal Revenue Service (IRS), filed proofs of claim [1] against each of the Debtors jointly and severally asserting priority tax claims under § 507(a)(7)(E) and (G) of the United States Bankruptcy Code or alternatively as administrative claims for "excise taxes" pursuant to 26 U.S.C. § 4971(a) and (b) (section 4971). The claims are based on the Debtors' failure to pay certain amounts due under their pension plans. Both the Debtors and the Official Unsecured Creditors Committee (Committee)[2] objected to the proofs of claim. The legal issues were presented to the court in a claims objection hearing on November 13, 1992.[3] Speedy resolution of the

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[1] The IRS filed an identical claim in each Debtor's case that will be referred to collectively as the proofs of claim.

[2] The Committee has fully participated in arguing the issues in dispute here, and its argument generally tracks and supports the position of the Debtors. Where reference is made to the position of the Debtors, the court acknowledges that the Committee's position is similar.

[3] The Debtors have also filed an adversary proceeding involving much the same arguments presented here, but including a prayer for equitable subordination under 11 U.S.C. § 506(c) as additional relief.

legal issues is critical. The Debtors' hopes for reorganization center upon the sale of portions of the Debtors' assets implemented through a proposed plan of reorganization. The prospective purchaser has established a schedule that requires resolution of these and other issues or its participation in the Debtors' reorganization will be withdrawn. If the court allows the status asserted by the IRS for its claims, it is unlikely that the Debtors will have sufficient funding to propose a feasible plan of reorganization. Because of the critical nature of the resolution of these core issues, the court issued a bench ruling at the hearing, but indicated that it would supplement the bench ruling with a written decision.

FACTS

At the time of filing, the Debtors were sponsors of two pension plans that provided pension and pension-related benefits for employees and retirees. CF&I Steel Corporation (CF&I) was the administrator of those plans. These two pension plans were the Pension Plan of CF&I Steel Corporation and Certain Subsidiaries (the Master Plan)and the Non-Contributory Pension Plan of CF&I Steel Corporation as Amended and Restated Effective January 1, 1989, (the Non-Contributory Plan). Under these pension plans, CF&I promised to provide fixed pension benefits calculated with reference to each employee's pay and years of service. CF&I was obligated to provide annual funding contributions based on the actuarial valuation of the benefits earned by its employees.

The Pension Benefit Guaranty Corporation (PBGC) is a wholly-owned United States government corporation established under § 4002 of the Employee Re-

tirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1302, to administer the pension plan termination provision of Title IV of ERISA, 29 U.S.C. §§ 1302-1461. The PBGC is required to guarantee payment of non-forfeitable or vested benefits under terminated pension plans, subject to certain limitations. If the PBGC pays pension benefits pursuant to its guaranty under the terminated pension plans, the funds do not come from the United States treasury, but from insurance premiums paid by sponsors of ERISA qualified plans.

CF&I failed to make the minimum funding payment of $12,400,000 on the Master Plan for the year ending December 31, 1989. The payment should have accompanied CF&I's form 5330 annual report that the parties agree was due on September 15, 1990. On November 7, 1990, the Debtors filed petitions for reorganization under chapter 11 of the Bankruptcy Code. Since the date of filing, the Debtors have not made any continuing minimum funding payments to the pension plans attributable to services rendered by employees before the date of filing. The annual reports and minimum funding payments for the year ending December 31, 1990, of approximately $12,100,000, were due September 15, 1991. The Debtors assert the pension plans are pre-petition obligations, therefore, the Debtors did not make the minimum funding payments for 1990.[4]

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[4] On March 13, 1991, the PBGC filed two proofs of claim against each of the Debtors in connection with the Master Plan. These claims fall into two general categories: (1) claims for unfunded benefit liabilities under the Master Plan (the Unfunded Benefit Claims) designed to reimburse the PBGC for at least a portion of the amounts that it must pay

The Debtors attempted to persuade the PBGC into terminating the Master Plan both before and after filing the chapter 11 petitions. It was not until March 19, 1992, that the PBGC instituted proceedings to terminate the Master Plan. The Non-Contributory Pension Plan has not been terminated. CF&I, on behalf of the Master Plan, consented to the termination and entered into a trusteeship agreement with the PBGC effective March 19, 1992, and the PBGC became the successor trustee of the Master Plan. The PBGC became liable for guaranteed benefits to plan participants.

IRS CLAIMS

Under section 4971(a), the IRS imposes an immediate 10% "first tier" tax based on the accumulated funding deficiency if the employer fails to make the minimum funding contribution by the date when the employer's annual report is due (in this case reports for both plan were due on September 15, 1990). If the sponsoring employer does not thereafter correct the accumulated funding deficiency by making the required contribution to the applicable pension

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to pensioners from its own funds; and (2) claims for due and unpaid minimum funding contributions allegedly due and owing the Master Plan (the Minimum Contribution Claims). On July 1, 1992, after termination of the Master Plan, the PBGC amended its proofs of claims, increasing the amount of each of the ten Unfunded Benefit Claims to an estimated amount of $263,200,000 and the amount of each of the ten Minimum Contribution Claims to an estimated amount of $64,874,511. The claims were filed variously as priority or administrative claims. The court has ruled that the majority of the PBGC's claims are pre-petition, unsecured claims, not entitled to priority or administrative payment status.

plan during the taxable period as defined in section 4971(c)(3), then section 4971(b) imposes an additional "second tier" tax on the employer equal to 100% of the amount of the accumulated funding deficiency.

On March 13, 1991, the IRS timely filed various proofs of claim asserting tax liability based on excise taxes pursuant to section 4971. The proofs of claim alternatively asserted secured or priority status for section 4971(a) liability for the 1989 plan year assessed January 21, 1991. They also included a claim indicating "examination liability unassessed" for the second tier excise tax for the 1989 plan year. The IRS audited the second tier tax for the plan year 1989, and issued a post-petition notice of deficiency to the Debtors for the 1989 second tier liability. The original proofs of claim made no reference to section 4971 liability for 1990, despite an assertion in the IRS memorandum to the contrary. The IRS audited the 1990 plan year and issued the appropriate notice letters to the Debtors on September 3, 1992. The proofs of claim indicate that the 1989 second tier and the 1990 first and second tier excise taxes remain unassessed.

The original proofs of claim filed by the IRS also included amounts for income taxes for 1983 and income taxes under audit for 1984 and 1985. The only amount indicated on the original proofs of claim regarding income tax liability for 1987, 1988, and 1989, was an amount owing of $.00 with an asterisk referring to an explanation in which the IRS asserted a "protective" claim.[5]

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[5] The original proofs of claim contained the following language: "No income tax liability is shown for the tax years

The IRS amended each of its proofs of claim on September 24, 1992, three weeks prior to the filing of the Debtors' disclosure statement, and after the claims bar date. The amended proofs of claim declare that the 1989 tax claimed pursuant to section 4971(a) is a pre-petition priority tax liability and asserts that the Debtors must pay, in addition to the claims of the PBGC for the underlying funding payment of $12,400,000, the following amounts:[6]

Plan Number[7]	1989 10% First Tier section 4971(a)
010	$ 1,205,047.00
008	$ 36,577.00

The amended proofs of claims state that the 1989 section 4971(b) and the 1990 section 4971(a) and (b) claims are post-petition tax liabilities entitled to administrative expense priority pursuant to 11 U.S.C. § 503(b)(1)(B)(i) in the following amounts:

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85 through 89 for the consolidated group of corporations of which CF&I Steel Corporation was the parent corporation. The returns for those years report net operating losses for all years except 1987. The carryback and/or carryforward of losses from other years to 1987 eliminates the income tax liability shown for 1987. These returns have not yet been audited but could be audited in the future for the purpose of eliminating any net operating loss carryforward which the debtor might attempt to claim."

[6] The IRS has asserted general unsecured claims for late payment penalties and interest of $198,713 for failure to pay the 1989 10% first tier penalties under section 4971(a).

[7] The IRS has designated the Master Plan as plan 010, and the Non-Contributory Plan as plan 008 in its proofs of claim.

Plan Number	1990 10% first tier section 4971(a)
010	$ 2,508,154.70
008	$ 54,258.80

Plan number	1989 100% second tier section 4971(b)
010	$12,050,472.00
008	$ 308,966.00

Plan number	1990 100% second tier section 4917(b)
010	$25,081,547.00
008	$ 542,588.10

Alternatively, if the court does not accord the claims post-petition administrative status, the IRS asserts the claims represent pre-petition priority taxes under 11 U.S.C. § 507(a)(7)(E) and (G). The amended IRS proofs of claim also seek income taxes and interest to the date of the petition of $265,910.62 due for the years 1987, 1988, and 1988 pursuant to an audit completed after the IRS filed the original proofs of claim.

On December 2, 1992, the Debtors filed objections to the IRS proofs of claim. The Debtors object to all the section 4971 excise tax claims asserted pursuant to 11 U.S.C. § 507(a)(7)(E) and argue that the claims are, in fact, penalties and must be disallowed. They also contend that the section 4971 excise tax claims are not pecuniary loss penalties related to a governmental claim under 11 U.S.C. § 507(a)(7)(G) and should be disallowed.[8] In addition, the Debtors objected to the 1989 section 4971(b) second tier claims and the 1990 section 4971(a) and (b) claims.

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[8] The Debtors object to the classification of the 1989 first tier claims as administrative claims under 11 U.S.C. § 503, but is not apparent from the amended proofs of claim that the IRS asserted administrative status for these claims.

They maintain that as of the date of filing, the taxable period had not expired and that they are still able to avoid the 100% penalty by correcting the accumulated funding deficiency for 1989, but that they are prohibited from so doing except pursuant to a plan of reorganization or as directed by this Court. The Debtors expect the IRS to assert section 4971(a) and (b) claims against the Debtors for each year, *ad infinitum*, in which the Debtors are prohibited from making the minimum funding payments by virtue of the filing of these chapter 11 proceedings. The Debtors also argue that any priority claims filed by the IRS for section 4971(a) and (b) claims for 1990 are late filed and should be disallowed.

The Debtors also object to those portions of the amended claims that add prepetition priority income tax liability for 1987, 1988, and 1989 as untimely filed. The IRS contends the 1987, 1988, and 1989 income tax liabilities were included in the initial timely filed claims by incorporating the protective language contained in the proofs of claim and that the claims filed after the bar date were merely amendments to cure defects in the previously filed claims.

ISSUES

A. The proofs of claim represent exactions that are not excise taxes allowed priority payment pursuant to 11 U.S.C. § 507(a)(7)(E), and are not pecuniary loss penalties allowed priority payment pursuant to 11 U.S.C. § 507(a)(7)(G).

The initial issue presented in resolving the Debtors' objections to the IRS's proofs of claim is to determine if the IRS's characterization of the claims as

excise taxes is correct. The IRS describes its claims as excise taxes based, not unreasonably, on the caption of section 4971 that indicates "Subtitle D-Miscellaneous Excise Taxes." All parties, however, acknowledge that the legislative history indicates that the excise taxes created in section 4971 are, in reality, penalties imposed upon an employer to prevent an accumulated funding deficiency under a plan.[9] No argument has been advanced that these claims in fact compensate the United States for actual pecuniary loss. Payment by the PBGC of any nonforfeitable or vested benefits under terminated pension plans is from premiums collected from all ERISA qualified plan sponsors, and not by the United States from general revenue. Though the IRS acknowledges that legislative intent indicates the taxes imposed are penalties, it asserts this court may not look at the actual nature of the exaction, but must rely on the designation stated by Congress in the statute and may not re-characterize the IRS's classification of the excise taxes.

The IRS relies on the Sixth Circuit's reversal of the lower courts in *In re Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991) *cert. denied sub nom, Krugliak v. United States*, 112 S.Ct. 1165 (1992), as being directly on point and controlling in

[9] The legislative history indicates: "The bill also provides new and more effective *penalties* where employers fail to meet the funding standards . . . This procedure, however, has proved to be defective since it does not directly *penalize* those responsible for the under-funding. For this reason, the bill places the obligation for funding and the *penalty* for under-funding on the person on whom it belongs—namely, the employer." H.R. Rep. No. 807, 93rd Cong., 2nd Sess. 28 (1974), reprinted in 1974 U.S.C.C.A.N. 4670, 4694-95 (italics added).

this case. *Mansfield* held that, since section 4971 was an existing federal excise tax at the time the Bankruptcy Code was enacted, Congress meant to include those exactions in the category Congress itself had previously deemed to be federal excise taxes under 11 U.S.C. § 507(a)(7)(E). *Mansfield* held that courts should not employ any other test to determine if the section 4971 taxes are in fact excise taxes. *Mansfield* indicated that such deference would not be given, however, in cases involving state and local exactions. In those instances, a federal question arises, therefore a federal court may determine whether the state or local tax characterization is correct when applied to the Bankruptcy Code.

The Debtors invite this court to conclude that *Mansfield* is unnecessarily rigid and contrary to prior law. Instead, they argue that this court is empowered to look behind Congress' characterization of the tax and should instead employ a four part test to determine if the assessment is properly characterized as a tax.[10] The IRS agreed that if the court employed

[10] In *County Sanitation Dist. No. 2 of Los Angeles County v. Lorber Industries of California, Inc. (In re Lorber Indus. of California, Inc.)* 675 F.2d 1062, 1066 (9th Cir. 1982), citing *Dugan v. Dept. of Agriculture, State of Cal.*, 332 F.2d 793 (9th Cir. 1964), the Ninth Circuit approved the following four part test to determine the elements of whether a state charge can be afforded tax priority under the Bankruptcy Act:

1) An involuntary pecuniary burden, regardless of name, laid upon individuals or property;

2) Imposed by, or under authority of the legislature;

3) For public purposes, including the purpose of defraying expenses of government or undertakings authorized by it;

4) Under the police or taxing power of the state.

such a test it would not be able to sustain the position that the section 4971 excise taxes are not penalties because it could not meet the third prong of the *Lorber Industries* test. *In re Cassidy*, 126 B.R. 94, 96-8 (Bankr. D. Colo. 1991); *In re Airlift Int'l., Inc.*, 120 B.R. 597, 601 (S.D. Fla. 1990).

This issue should be viewed in the context of the Tenth Circuit's controlling instruction that courts should not interpret a statute so that the literal meaning of the words thwarts the obvious purpose of a statute. *State of Okla. ex. rel., Dept. of Human Serv. v. Weinberger*, 741 F.2d 290, 292 (10th Cir. 1983). Even in *Mansfield*, the court acknowledged that there are "rare cases" in which the literal application of a statute will produce a result at odds with the intent of the statute. *Mansfield*, 942 F.2d at 1059, citing *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). Courts should also be circumspect in interpreting ERISA, or related provisions of the Internal Revenue Code, in a manner that alters or impairs the Bankruptcy Code.[11]

This court concludes that the label adopted by Congress in its characterization of these excise taxes is not controlling, especially where blind acceptance of the label would defeat the purpose of the Bankruptcy Code. *United States v. Unsecured Creditors Comm. of C-T of Va., Inc. (In re C-T of Va.)*, 1992 WL 247459 (4th Cir., Oct. 2, 1992) (it is the purpose of

[11] ERISA § 514(d), 29 U.S.C. § 1144(d), indicates that in interpreting ERISA, "nothing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(c) of this title) or any rule or regulation issued under any such law."

the tax, not its name, that controls); *United States v. River Coal Co., Inc.*, 748 F.2d 1103, 1106 (6th Cir. 1984) (fact that Congress labeled a reclamation charge a fee rather than a tax is not controlling); *In re Unified Control Sys., Inc., v. I.R.S. (In re Unified Control Sys., Inc.)*, 586 F.2d 1036, 1037-38 (5th Cir. 1978) (label placed upon an imposition in a revenue measure is not decisive in determining its character); *United Steelworkers of America, AFL-CIO-CLC v. PBGC (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672, 693 (W. D. Penn., 1989) (the mere label of an exaction as a tax will not govern its characterization for purposes of bankruptcy law); *Kline v. Feinblatt*, 403 F. Supp. 974, 977 (D. Md. 1975) *aff'd.* 547 F.2d 823 (4th Cir. 1977) (finding §§ 4941 and 4944 of the IRS Code to be penalties, court indicated the name given to the exaction by the legislature is not conclusive).[12]

This case presents one of those "rare cases" where the court should examine the characterization of the statute because of the obvious inconsistencies that arise if the excise tax status is upheld. First, unlike *Mansfield*, the IRS's section 4971 claims are for both the first and the second tier taxes. This court previously found that the claims of the PBGC for the underlying obligation are, for the most part, pre-petition unsecured claims. To allow priority treat-

[12] *Mansfield* considered but rejected *Unified Control Systems, River Coal Co.* and *Kline*, considering them as wrongly decided because they blurred the distinction between a federal question involving a state statute and a characterization made by Congress. Each case, however, found additional equitable reasons for looking behind the label applied to a tax when considered in light of the purpose of the applicable statute.

ment for alleged tax claims based on pension funding deficiencies, when the pension plan's claims do not receive such treatment, would elevate the section 4971 claims to a status ahead of those claims. Second, such an interpretation would result in state and local taxes being subject to judicial scrutiny, but not federal taxes. The effect could be that state taxes would be treated differently or accorded different priority than federal taxes and the Bankruptcy Code does not contemplate such disparate treatment. Third, the payment of such large priority claims would defeat any attempt by the Debtors to reorganize, would prevent any return to creditors and would provide a windfall to the IRS. Fourth, such an interpretation would harm the parties that are intended to be protected by the pension plan that section 4971 seeks to enforce, because payment of section 4971 penalty claims would be at the expense of pre-petition unsecured creditors including pensioners. Fifth, allowance of the 1990 first and second tier claims and the 1989 second tier claims would penalize the Detbors for obeying the Bankruptcy Code. The Debtors complied with the Bankruptcy Code by not paying pre-petition debts outside a plan of reorganization. However, it is the Debtors compliance with the Bankruptcy Code that results in the accrual of the section 4971 claims after the date of filing.[13] Based upon the fore-

[13] In *In re Wheeling-Pittsburgh Steel Corp.*, 103 B.R. 672, 694 (W.D. Pa. 1989), the court found that the IRS's claims under section 4971 were penalty claims for bankruptcy purposes. Since Wheeling-Pittsburgh was forbidden from paying pre-petition plan contributions post-petition under the bankruptcy law, equitable considerations dictated that the IRS's claims be disallowed so as not to punish the debtor's credtiors.

going, the court finds that it is empowered, under the circumstances of this case, to look behind the characterization of the exaction set forth in the statute and focus on the actual nature of the claims. Based on its own independent application of the four pronged test advanced in *Lorber Industries*, the court finds the IRS has failed to meet the third prong of the test. The excise taxes are penalty claims, and that the penalty claims are not assessed as compensation for the government's actual pecuniary loss. Therefore, to the extent that the IRS's section 4971 claims for 1989 and 1990 are deemed to be pre-petition claims, they are not afforded priority status under § 507 (a)(7)(E) or (G).

B. The section 4971 penalty claims are not entitled to administrative status under 11 U.S.C. § 503.

The Debtors object to the IRS's proofs of claim that assert post-petition administrative status for the penalty claims. The IRS argues that its 1989 and 1990 section 4971(b) claims all accrued post-petition because either the notice of deficiency was mailed or the date of assessment occurred post-petition creating administrative expenses.[14] Likewise the

[14] The IRS argues that the section 4971(a) excise tax accrues as of the date eight and one-half months after the end of the plan year, or for 1989, on September 15, 1990. *See*. Temp. Treas. Reg. § 11,412(c)-12(b). The IRS also takes the position that the section 4971(b) claims accrue as of the earlier of the date of mailing of a notice of deficiency with respect to the penalty imposed by section 4971(a) or the date of assessment of the tax if the funding deficiency has not been cured. Section 4971(a)(3)(A) and (B). In this case, both the notice of deficiency and the date of assessment, if any, for the 1989 section 4971(b) and the 1990 section 4971(a) and (b) occurred post-petition.

1990 section 4971(a) liability arose as a result of the post-petition failure of the Debtors to pay the accumulated funding deficiency on September 15, 1991. The IRS's statement of the date these events transpired is correct, but the IRS's position ignores the effects the filing of the Debtors' chapter 11 petitions had on the underlying obligation.

The IRS declares that a tax is incurred by the estate on the date that the tax accrues. *See, e.g., In re O.P.M. Leasing Servs., Inc.*, 68 B.R. 979 (Bankr. S.D.N.Y. 1987); *accord Wheeling-Pittsburgh Steel Corp.*, 103 B.R. at 693. Because the IRS sent notice of deficiency for the 1989 and 1990 section 4971(b) claims post-petition, and because the IRS assessed the penalties post-petition,[15] the IRS argues the penalties were incurred as administrative expenses.

The difficulty with the IRS's approach is that it presumes that it assessed excise taxes instead of penalties, and that an obligation has been incurred by the Debtors post-petition in spite of the operation of the automatic stay. The Bankruptcy Code prevented payment of the pre-petition obligation that is the foundation of the IRS penalty claims. The operation of the

[15] IRS relies upon the District Court Rule of Bankruptcy Practice and Procedure, D. Utah 508, that indicates that the stay afforded by 11 U.S.C. § 362 is modified to allow the IRS to assess tax liabilities unless a party in interest objects and the court orders otherwise. This provision is of no comfort to the IRS because it allows for the assessment of taxes, not for the assessment of penalties such as the section 4971 claims asserted in this case.

automatic stay tolled the correction period so that the claims have not yet been incurred and remain contingent claims. Therefore, there are no taxes to which the penalties attach.

The bankruptcy filing prohibited the Debtors from making any payment on the underlying pre-petition obligation that is the basis for the penalty claims, except payment through a plan of reorganization or as ordered by the court. *Official Comm. of Equity Security Holders v. Mabey (In Re A.H. Robins Co.)*, 832 F.2d 299, 302 (4th Cir. 1987), *cert. denied*, 485 U.S. 962 (1988). Since the basis for the IRS's proofs of claim for these periods is the Debtors' compliance with the Bankruptcy Code, it would be inequitable to allow the claims. Any failure to make such contribution is protected under bankruptcy law and cannot be penalized by the IRS. *Wheeling-Pittsburgh Steel Corp.*, 103 B.R. at 693.

The penalty claims are also contingent because section 4971(b) provides that the claims do not arise unless the accumulated deficiency is not *corrected* within the taxable period. The correction period does not expire until at least ninety days after the date on which the IRS mails notice of deficiency for the 10% first tier penalty due under section 4971(a). Under section 4961(a), the correction period is extended for ninety days following the mailing of the notice of deficiency, and for any additional time beyond the ninety days during which "a deficiency cannot be assessed under section 6213(a)" of the Internal Revenue Code. 26 U.S.C. §§ 4961(a), 4963(e)(1). One such period is the period during which a debtor is prevented from filing a petition in the United States Tax Court, and for sixty days thereafter. Since 11

U.S.C. § 362(a)(8) precludes the commencement or continuation of a proceeding before the United States Tax Court, the correction period extends until sixty days after the conclusion of the bankruptcy proceeding. Therefore, the running of the correction period is tolled during the period in which the automatic stay is in effect and no 100% penalty may be assessed. *Wheeling-Pittsburgh Steel Corp.*, 103 B.R. at 695.

The 1989 plan year correction period was still open as of the date of filing of these petitions and remains open. The notice of deficiency for 1990 was issued while the automatic stay was in effect, therefore, the correction period cannot expire until 150 days after the date on which the stay expires. The Debtors argue that the term "correct" means to contribute to the pension plan the amount necessary to reduce the accumulated funding deficiency, as of the end of the plan year, to zero. The confirmation of a plan operates to discharge "all claims and interest of creditors," thus effectively reducing all claims to zero. 11 U.S.C. § 1141. The Debtors propose that the prepetition claims related to the pension plans can be cured or corrected through their proposed plan. This may be correct, but the proposed plan has not been confirmed and the court makes no determination at this time that such a provision would cure or correct the funding deficiency. The court reserves any ruling based upon this theory until the facts of the case support consideration of the argument.

The language of 11 U.S.C. § 503(b)(1)(C) grants administrative status to "any fine, penalty or reduction in credit *relating to a tax of a kind specified in subparagraph (B) of this paragraph*." 11 U.S.C. § 503(b)(1)(C) emphasis added). The logical in-

terpretation of this language is that such penalty must relate to a tax allowed administrative status under 11 U.S.C. § 503(b). Though it may be argued that 11 U.S.C. § 503(b)(1)(C) includes penalties without the restriction that such penalties be compensation for actual pecuniary losses and may therefore include section 4971 penalties, these penalties do not relate to a tax. The Debtors are subject to section 4971 liability on the accumulated funding deficiency in the qualified plan resulting from failure to make minimum contributions to the plan rather than failure to pay any identifiable, separate, revenue producing tax. The only obligation related to the section 4971 penalty is the obligation owed by the Debtors to fund the pension plan, or upon termination of the plan, the obligation to pay any under-funding to the PBGC. The Debtors simply have no underlying obligation owing to the United States that can be characterized as a tax.

Based upon a consideration of all the foregoing factors, the court finds that the IRS's proofs of claim for 1989 section 4971(b) and for 1990 section 4971(a) and (b) are disallowed and expunged. *See, e.g., LTV Corp. v. IRS, (In re Chateaugay Corp.)*, slip op. Nos. 92 Civ. 3394, 3395 (S.D.N.Y. October 19, 1992). If the Debtors fail to confirm a plan that cures the accumulated funding deficiency, the IRS may be entitled to file an administrative claim and again assert administrative status for a portion of its proofs of claim. But for a determination whether such claims may be allowed must await circumstances different from those currently before the court.

C. The timeliness of the IRS proofs of claim raises issues of fact that must be resolved through an evidentiary hearing.

The third basis for the Debtors' objections to the proofs of claim is that a portion of the claims are untimely. The Debtors contend that the IRS should not be permitted to amend its proofs of claim to assert additional income tax liabilities for 1987, 1988 and 1989, or to assert new pre-petition section 4971 liabilities for 1990. The IRS argues that the protective language in the original proofs of claim clearly placed the 1985 through 1989 income tax liabilities in issue. The IRS reasons that the original proofs of claim may not have indicated the exact nature of the tax liability, but the Debtors were on notice that an income tax audit could be anticipated for those years. The IRS admits that there was no specific language in the original proofs of claim regarding the 1990 liability under section 4971 because the IRS viewed this liability as post-petition administrative liability. However, the IRS argues that its original proofs of claim did inform the Debtors of the general concept of placing these liabilities at issue. Nonetheless, the IRS claimed the 1990 excise taxes as priority prepetition taxes as well as post-petition administrative taxes.

Although amendments to proofs of claim may be freely permitted "to cure a defect in the claim as originally filed," a creditor may not assert new claims after the bar date under the guise of amending its claim. *In re Unioil, Inc.*, 962 F.2d 988, 992 (10th Cir. 1992) (quoting *LeaseAmerica Corp. v. Eckel*, 710 F.2d 1470, 1473 (10th Cir. 1983)). In *Unioil*, an individual creditor sought by motion to amend his

proof of claim to identify a trust as the proper principal on whose behalf he was pursuing the claim. The court held that ordinarily an amendment of a proof of claim is freely permitted so long as the claim initially provided adequate notice of the existence, nature, and amount of the claim as well as the creditor's intent to hold the estate liable, but a truly new claim should not be permitted. The court found that the original proof of claim at issue in that case was adequate and that its content was unaltered by the requested amendment. The court concluded that under the particular circumstances before it, the debtor was not prejudiced by the amendment because the amended proof of claim asserted the same substantive interests as the original proof of claim. *Unioil*, 962 F.2d at 993.

The IRS suggests that in *Unioil*, the Tenth Circuit took a more liberal approach to claims amendment than the traditional view. This court finds nothing in the *Unioil* decision that deviates from the traditional narrow standard that an amendment is permitted only where the creditor provided notice to the debtor of the existence, nature and amount of the claim and the creditor's intent to hold the estate liable. *Walsh v. Lockhart Assocs.*, 339 F.2d 417 (5th Cir.), *cert. denied*, 380 U.S. 953 (1965).

The IRS' original proofs of claim listed income tax liability for 1985-89 as $.00. The IRS reserved the right to audit the Debtors' returns for tax years 1985 through 1989 for the "purpose of eliminating any net operating loss carryforward which the debtor might attempt to claim." The IRS may have intended the Debtors to infer from this protective language notice that some amount of additional income tax liability

may arise from the audit as a result of a change in calculating the loss carryforward which the Debtors were entitled to claim. The IRS admits that liability for "alternative minimum tax was not identified in the proof of claim but was clearly a possibility from the audit." IRS Response at p. 24. It does not appear from this anticipatory language that the IRS could maintain a claim for additional income tax liability if the audit produced evidence and the amended proofs of claim were based, for example, on the Debtors under-reported income or resulted from improper claims of other types of deductions.

Even if it were reasonable to make such an inference regarding the existence and nature of the additional tax liability resulting from elimination of a loss carryforward, the amount of the additional tax liability could not be even remotely inferred from the original claim. It is unlikely that, on its face, an inference of increased tax liability without any indication of the amount of increase supplies sufficient notice to the Debtors to open the door for a later amendment intended merely to cure a defect. In this case, whether: (1) the original proofs of claim were sufficient to provide notice of the nature of the IRS's claim; (2) the Debtors made the correct inference from the original proofs of claim and; (3) the additional income tax liability actually resulted from adjustment to the amount of loss carryforward available to the Debtors is a factual determination that the court reserves for a later evidentiary proceeding.

D. The 1990 priority tax proofs of claim are untimely filed.

The IRS admits that the amendment to add the section 4971 liability for the Debtors' 1990 pension

plan funding deficiency is problematic. It is clear from the original proofs of claim that the IRS attempted to protect its claim for section 4971 liability for the plan year ending December 31, 1989. The IRS reasons that the protective language regarding the 1989 excise tax put the Debtors on notice of the general concept of continuing liability for subsequent years. The IRS also relies on its characterization of section 4971 penalties as an administrative expense liability for its failure to anticipate and include the 1990 section 4971 liability on the original proofs of claim. The IRS claims priority status for the 1990 section 4971 claims as well as administrative expense status.

As the IRS noted, many courts summarily disallow amended claims to add additional tax periods for the same type of tax. *See, e.g., In re Butcher*, 74 B.R. 211 (Bankr. E.D. Tenn. 1987). Other courts allow addition of another tax period of the same type of liability as an almost automatic amendment. *See, e.g., In re Bajac Const. Co.*, 100 B.R. 524 (Bankr. E.D. Cal. 1989). Even under the most generous standard of freely allowing amendments used by other courts outside the Tenth Circuit, if the 1990 liability was determined to be a pre-petition obligation, the amendment to add new and unspecified liability for the 1990 section 4971 penalties could not be allowed. In the present case, the reorganization is too far along and the various parties that have struggled over formulation of a plan would be adversely prejudiced if the court permitted such an amendment. Furthermore, applying the two-step analysis of *Unioil* leads to the same result. Even if it could be argued that the Debtors had notice of the existence and amount

of the 1990 excise liability, such an amendment does much more than merely cure a defect, it creates a new claim. This new claim would insolubly delay and complicate the administration of this estate. Permitting a late-filed amendment for an additional tax period that triples the amount of the original claim this close to plan confirmation cannot be justified under these circumstances. The court will not exercise its discretion to allow such an amendment.

CONCLUSION

In accord with the above determination, the section 4971 assessments against the Debtors are in fact penalties that do not compensate the United States for actual pecuniary loss. The penalties asserted by the IRS as administrative claims are disallowed and expunged because the proofs of claim penalize the creditors of these Debtors for the Debtors' compliance with the Bankruptcy Code's prohibition against satisfaction of pre-petition claims absent a confirmed plan of reorganization, because of their contingent nature, and because the Debtors' right to cure any deficiency has not expired. The court will not as a matter of law disallow the pre-petition income tax claims, but will reserve ruling thereon pending an evidentiary hearing.

Based upon the forgoing, it is hereby

ORDERED, as follows:

1) the 26 U.S.C. § 4971(a) and (b) proofs of claim for excise taxes are in fact penalty claims and are therefore denied priority status under § 507(a)(7)(E);

2) the 26 U.S.C. § 4971 (a) and (b) proofs of claim are not in compensation for actual pecuniary loss and are therefore denied priority status under § 507(a)(7)(G);

3) the 1989 26 U.S.C. § 4971(b) and the 1990 26 U.S.C. § 4971(a) and (b) proofs of claim are not entitled to administrative status and are expunged;

4) the 1989 26 U.S.C. § 4971(a) proofs of claim are pre-petition unsecured claims;

5) no determination is made at this time as to whether any pre-petition unsecured claim asserted by the IRS is subject to equitable subordination;

6) to the extent that the 1990 penalty claims may have accrued pre-petition, they are disallowed because such claims were not timely filed;

7) the court reserves ruling as to whether the 1987, 1988, and 1989 income tax liability contained in the amended proofs of claim were timely filed pending an evidentiary hearing; and

8) future proofs of claim filed by the IRS pursuant to 26 U.S.C. § 4971 that may arise because of the Debtors' failure to cure or correct the prepetition accumulated funding deficiency are not entitled to preferred status until such time as this court determines that no cure or correction of the deficiency has been effectuated.

DATED this 25 day of November, 1992.

/s/ Judith A. Boulden
JUDITH A. BOULDEN
United States Bankruptcy Judge

APPENDIX F

1. Section 507, 11 U.S.C. (1988), provides in relevant part:

(a) The following expenses and claims have priority in the following order:

* * * * *

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—

* * * * *

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

* * * * *

2. Section 510, 11 U.S.C., provides in relevant part:

* * * * *

(c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may—

(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an al-

lowed interest to all or part of another allowed interest; or

(2) order that any lien securing such a subordinated claim be transferred to the estate.

3. Section 4971, 26 U.S.C. (1988), provides in relevant part:

(a) Initial tax

For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the plan, determined as of the end of the plan year ending with or within such taxable year.

(b) Additional tax

In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

(c) Definitions

For purposes of this section—

(1) Accumulated funding deficiency

The term "accumulated funding deficiency" has the meaning given to such term by the last two sentences of section 412 (a).

(2) Correct

The term "correct" means, with respect to an accumulated funding deficiency, the contribution, to or under the plan, of the amount necessary to reduce such accumulated funding deficiency as of the end of a plan year in which such deficiency arose to zero.

(3) Taxable period

The term "taxable period" means, with respect to an accumulated funding deficiency, the period beginning with the end of the plan year in which there is an accumulated funding deficiency and ending on the earlier of—

(A) the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (a), or

(B) the date on which the tax imposed by subsection (a) is assessed.

(d) Notification of the Secretary of Labor

Before issuing a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity (but not more than 60 days)—

(1) to require the employer responsible for contributing to or under the plan to eliminate the accumulated funding deficiency, or

(2) to comment on the imposition of such tax.

In the case of a multiemployer plan which is in reorganization under section 418, the same notice and opportunity shall be provided to the Pension Benefit Guaranty Corporation.

(e) Liability for tax

(1) In general

Except as provided in paragraph (2), the tax imposed by subsection (a) or (b) shall be paid by the employer responsible for contributing to or under the plan the amount described in section 412(b)(3)(A).

(2) Joint and several liability where employer member of controlled group

(A) In general

In the case of a plan other than a multiemployer plan, if the employer referred to in paragraph (1) is a member of a controlled group, each member of such group shall be jointly and severally liable for the tax imposed by subsection (a) or (b).

(B) Controlled group

For purposes of subparagraph (A), the term "controlled group" means any group treated as a single employer under subsection (b), (c), (m) or (*o*) of section 414.

* * * * *

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